The Gap, Inc. (GPS) CEO Robert Fisher on Q3 2019 Results - Earnings Call Transcript

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FQ3: 11-21-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.53 beats by $0.02 | Revenue of $4B (-2.23% Y/Y) beats by $33.65M

Earning Call Audio

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The Gap, Inc. (NYSE:GPS) Q3 2019 Earnings Conference Call November 21, 2019 5:00 PM ET

Company Participants

Tina Romani - Senior Director, IR

Robert Fisher - President and CEO

Teri List-Stoll - EVP and CFO

Conference Call Participants

Randy Konik - Jefferies

Matthew Boss - JPMorgan

Mark Altschwager - Robert W. Baird

Oliver Chen - Cowen and Company

Westcott Rochette - Evercore ISI

Kimberly Greenberger - Morgan Stanley

Dana Telsey - Telsey Advisory Group

Operator

Good afternoon, ladies and gentlemen. My name is Justin and I will be your conference operator today. At this time, I would like to welcome everyone to The Gap, Inc. Third Quarter 2019 Conference Call. At this time, all participants are in a listen-only mode. [Operator Instructions].

I would now like to introduce your host, Tina Romani, Senior Director of Investor Relations.

Tina Romani

Good afternoon, everyone. Welcome to Gap, Inc's third quarter 2019 earnings conference call. Before we begin, I'd like to remind you that the information made available on this webcast and conference call contains forward-looking statements.

For information on factors that could cause our actual results to differ materially from the forward-looking statements as well as the description and reconciliation of non-GAAP financial measures as noted on Page 2 of the slides supplementing Teri's remarks, please refer to today's earnings press release as well as our most recent annual report on Form 10-K and our subsequent filings with the SEC, all of which are available on gapinc.com. These forward-looking statements are based on information as of November 21, 2019 and we assume no obligation to publicly update or revise our forward-looking statements.

Joining me on the call today are Interim President and CEO, Robert J. Fisher and Executive Vice President and CFO, Teri List-Stoll. As mentioned, we will be using slides to supplement our remarks, which you can view by going to the Investors section at gapinc.com.

With that, I'd like to turn the call over to Bob.

Robert Fisher

Thank you, Tina. Good afternoon, everyone. It's a pleasure to speak with you all. It's been a while for me. I want to provide some very brief remarks before turning it over to Teri to cover third quarter results and expectations heading into fourth quarter. First, this is a pivotal time for the company and taking on the role as Interim President and CEO of Gap, Inc. is incredibly important to me.

Over the past 35 plus years in various roles here, from merchandising and general management to Chairman of the Board, I have gained a deep understanding of our company operations and the retail space. I'm deeply and personally committed to the success of the company and I'm approaching the role with both a clear view of where we are and urgency about where we need to go.

While I'm confident about our future, I'm also realistic about the challenges ahead. Clearly our brands are underperforming today and have been pressured by uneven execution. The diverging priorities of our two largest brands, coupled with the overall complexity that has been building up in the organization over time has led to a lack of focus, operational discipline and efficiency in many areas. To ensure we're appropriately assessing the business, making the difficult decisions and taking the necessary action to improve our operational execution, I'm constituting an executive committee that will streamline operating decisions and drive better accountability during this interim period. Sonia Syngal and Mark Breitbard will be responsible for brand leadership, Teri will add operational oversight to her role, and our Global General Counsel, Julie Gruber will consolidate administrative oversight.

We're fortunate that a strong bench of talented leaders supporting me in driving operational excellence and greater efficiency that will help position us for improved profitability. To that end, the board and I continue to believe in the strategic rationale of the separation and the benefits it is expected to provide.

First, the focus provided by separation will enable both Gap, Inc. and Old Navy to better serve their two distinct customer sets, each with an operating model tailored to their respective business needs. Old Navy is competing with companies that have a singular focus on winning in the value space. We need Sonia and her team to have that same focus. Second, the separation will be a catalyst to drive improved cost and efficiency as we rebuild the organizational structure and operating models for both companies. Both companies will benefit from this but new Gap, Inc. in particular will have renewed urgency and catalyst to reinvent how it operates. Third, and perhaps most importantly, the separation will better empower each company to fully embark upon its unique path for growth and in the case of our mature brands path towards enhanced profitability.

This empowerment will come with the increased accountability of a standalone public company and the employees will benefit from the direct alignment of their performance to the value creation it creates. As we move forward with the work to prepare for separation, we remain confident in the value creation opportunities it presents inclusive of our current view of the business and the expected cost of the transaction. We plan to take the necessary time needed to make sure that both companies are positioned for success. And we're committed to providing transparency at every step of the way.

Lastly, I am sure that you will have several questions around our search for a permanent CEO. So I will quickly address them now. It has been only two weeks since our announcement. So I will not be providing any specific search criteria updates today. I'll share that we plan to move with urgency but also thoughtfully considering both internal and external candidates to ensure that we find the most qualified person for this role. As the board evaluates potential successors, our focus will be on strong leadership candidates with operational excellence that can lead a creative organization with greater efficiency, speed, and profitability. With that, I'd like to turn it over to Teri.

Teri List-Stoll

Thanks, Bob. As we shared a few weeks ago, Q3 was a challenging quarter, the traffic trends remained soft across our brand, along with continued product acceptance challenges, particularly at Old Navy. I'll start with an overview of performance by brand before getting into the specifics of the quarter. Starting with Old Navy. While we're not pleased with our performance we entered the quarter knowing we would face headwinds particularly around traffic. As we discussed with you last quarter history has shown us that traffic rebounds typically lag product acceptance improvement, as such traffic remains challenging throughout the quarter.

With regards to product, while we believe we have correctly diagnosed our women's product issues, we have identified opportunities for better execution, particularly in the areas of marketing and merchandising. To this end, we have added a new Chief Creative Officer role that leads these two critical areas and acts as a direct link to our Brand President. While our Chief Creative Officer's full vision will likely not be realized until next year, the brand strong bench of creative talent has been hard at work incorporating learnings from Q3 into holiday plans. Looking ahead, we have an opportunity to better execute on Old Navy's unique value equation and positioning, with style, fit, quality and price, all working in balance.

Focusing on Old Navy's Q4 plans, we believe that we are better positioned for the holiday season given that we were able to fully infuse key learnings and insights from Holiday 2018 into our plans. It's also important to note that three key categories we began leaning into this fall Denim, Fleece and Active continue to outperform the overall brand in terms of sales and margin comps and we have gained market share in Denim.

Regarding marketing, we had frankly become too heavily dependent on messaging around discounting, as opposed to bigger picture brand messaging focus on product and value that we know resonates with the Old Navy consumer. For Q4, we recalibrated our messaging to focus on product stories, highlighting some of our big design ideas for holiday, such as plaids, puffers and Jingle Jammies combined with compelling price points and commercial plans, which is more reflective of Old Navy's winning value equation.

Additionally, we have strategically increased our marketing investments, which include exciting new partnerships and campaigns. For example, earlier this month, we launched our Holiday TV campaign, featuring Neil Patrick Harris, and early test results have been some of the most positive we have ever seen from our iconic celebrity led campaign.

Also, this season Old Navy is the exclusive retail partner for Netflix's first ever animated family holiday movie, Klaus. This partnership includes character inspired products, in-store activations, and augmented reality experiences that will bring the movie to life for those who shop in Old Navy stores this season.

While we believe we've made the necessary pivots in terms of marketing and execution holiday, and are encouraged by the trends we have been seeing as the weather turned, we remain cautiously optimistic acknowledging that much of the season still lies ahead.

Before I turn to the other brands, I want to acknowledge a difficult decision made by management and the Board with regards to Old Navy's operations in China. As we continue to increase focus on investments that yield the best returns, we've made the decision to exit Old Navy from China in early 2020. The investment needed to grow the business would be significant. And we see greater value creation opportunities by focusing on other higher returns strategies, such as increasing our digital capability and continuing to invest in the proven growth opportunity in underserved North American market.

Our views on the fundamental strength of the business and the power of the Old Navy brand remain unchanged. The brand has maintained its position as the number two apparel brand and number nine apparel retailer in the U.S. We're holding our market share 3%, meaning we have tremendous opportunity for growth to category focus and expansion, giving customers more access, acquiring new customers to personalization and loyalty and driving online growth.

Through successful execution of our strategic priorities, we look forward to the business returning to the growth rates, we know it can deliver.

Now turning to Gap, as it's been the case all year, the team continues to focus on profitability, primarily through improved product assortment and inventory composition, as well as reduced promotional activity. Similar to last quarter, we saw positive sales over traffic across all channels, indicating continuing improvement in customer response to product. Q3 was the third consecutive quarter with improved margin rates versus last year. Recall it in 2018, we saw sequential improvement in margin rate as we move through the year.

Given the first half compares were relatively easy, we were pleased to see margin expansion continue in the third quarter ahead of our expectations. In fact, this was the first quarter where all major product divisions women's, men's, and kids and baby delivered margin expansion, and the first quarter with positive global AUR growth.

During Q3, we reduced the number of all box discount events both in-stores and online versus last year, and we converted to more flexible promotional messaging, focusing on an up to a certain percent off as opposed to blanket promotions on all products. We also made strides towards closing the gap between in-store and online promotional activity. We believe that this pricing transparency will build customers confidence that they’re receiving the best possible price no matter what channel they choose to shop, ultimately helping to boost Gap’s overall brand image. Separately and as discussed during prior calls, The Gap brand has been focused on reestablishing its authority in denim and its work really came to life with our Fall launch, supported by the “It’s Our Denim Now” marketing campaign at the end of August.

The response particularly in women's has been strong, with global denim sales and margins both comping positively in the quarter. Despite these positives, we still have much work ahead to restore profitability to the Gap brand. The margin rate improvement has not been sufficient to offset the negative revenue trends and leverage the cost structure. Going forward we will continue to focus on how we can best leverage the process and marketing improvement that delivered pockets of improvement in Q3.

We will also continue to transform the operating model with an eye towards the goal of dramatically increasing GMROI. Moving to Banana Republic, overall our Q3 results were disappointing. Our minus three comp simply didn't reflect the sequential improvements that we had expected coming into the quarter. Sales were challenged due to some product softness particularly related to warmer than anticipated weather, as well as a sub-optimal mix in key sizes as the brand works to fully implement a new inventory management tool.

We also sold through some key fashion items quickly and we're over invested in basic styles. One of Banana’s top priorities is to increase profitability by reducing the promotional levels the brand had migrated to in the past, when product acceptance was not strong. With improved product and leaner inventories now is the time to retrain our customers by implementing a more strategic promotional strategy that balances the need to drive traffic but also improve yields. This is a journey that will take some time as we evaluate the levers including the extensive nature of marketing investments, and implications necessary to optimize growth and profitability.

Bigger picture, we're continuing to engage with our consumers in new ways. For example, our recently launched rental business that is relevant for our overall P&L has attracted a larger following than planned and it's already providing valuable insight into customers. We have amassed 7,000 rental customers to our e-mail list and we're pleased to see that a large number of signups are coming from new customers to the brand. Also BOPIS has been fully rolled out to our BR fleet as of Q3 and already makes up nearly 5% of online sales.

Before I turn to slide, I wanted to provide some color around some of the movement within the other sales category in the net sales table within our press release. You'll recall that with the revenue recognition changes last year, a portion of our credit card income is now reported in other sales. While the majority falls within the brand net sales, I'm sorry these presentation changes can cause volatility in the other sales category, which are not reflective of the performance of our overall credit card program.

We don't disclose the specifics of the program, it is worth noting that the total credit card revenue was higher year-to-date. I will now turn to Athleta first, I want to welcome Mary Beth Laughton, who joined as President and CEO of Athleta in September. Mary Beth who was most recently at Sephora brings a strong background and proven track record of results in both digital and in-store operations.

We welcome her insights and are confident that she is the right leader as the brand continues upon its path towards $2 billion in revenues. Regarding Q3 performance for Athleta, it continues to be a brand with tremendous growth potential. During the quarter, we grew market share and maintained strong performance in key franchise collections like Powervita, City and Hybrid. Our girls business continued to be a consistent growth lever, delivering another double-digit comp quarter. That said, we did see some softness in the business at the start of the quarter, which we quickly diagnosed as largely being associated with two levers in-store traffic and assortment mix.

Regarding in-store traffic, we believe this was impacted by some changes we made to our marketing messaging invite how our in-store product was displayed, both of which has since been corrected for Q4. Given Athleta’s lower brand awareness as compared to our other brands, we have been increasing marketing investments and are still working to refine our messaging in a way that drives both in-store and online traffic.

On the assortment presentation, there were two issues. First our initial Q3 flows were more Fall forward in color and weight, which didn't work well, particularly in light of the warmer weather at the start of the quarter. Additionally, the assortment mix over index to performance were at the expense of lifestyle. We've taken immediate steps to rebalance our product assortment in Q4 towards a more appropriate mix of performance, which has historically made up around 50% of our total versus the 60% in Q3.

As weather shifted in October, we saw improving trends in-stores with positive indicators, such as higher average transaction and improving sales over traffic. And we're optimistic about carrying this momentum into Q4. We feel good about our holiday gifting assortment and added an additional flow to insert newness and give our customer a reason to keep coming in and shopping with us throughout the season.

Looking ahead, our team remains focused and growing market share and continues to believe that our inclusive brand positioning, unique product offering and high touch experiential store service model sets us up to win in this competitive retail landscape. We've accelerated store openings to around 30 this year, in line with our strategy to accelerate growth and we now expect to end the year with 190 Athleta stores.

Turning to our earnings outlook for the remainder of the year in fiscal 2019, we now expect net sales to decline low single digits versus prior guidance of flat and comp sales to decline mid-single digits versus prior guidance of low single digits. On a reported basis, we expect earnings per share to be in the range of $1.38 to $1.47 for the full-year. We continue to expect restructuring related costs to be about $0.14. We remain on track to close about 230 specialty stores by the end of 2020, with about 130 store closures completed in 2019 and we continue to expect total cost of the program to be about $250 million to $300 million with the majority expected to be cash expenditures.

That said, our discussions with landlords around closures continue to be challenging. Given the challenges associated with our specialty fleet, we simply must continue to rationalize those stores that don't generate sufficient returns to warrant the investments necessary to provide our customers with a differentiated experience, however really to execute on our strategy as quickly and decisively as we would have liked will continue to be a challenge.

In fiscal 2019, we expect costs associated with preparing for and executing the separation to be in the range of $0.40 to $0.44. As the work evolve, we'll continue to provide additional information and context.

Excluding the first quarter gain on sale of a building costs associated with preparing and executing the separation, restructuring costs and any tax related impacts as well as the second quarter tax reform adjustments, we expect adjusted earnings per share to be in the range of $1.70 to $1.75. With regards to gross margin, we now expect full-year gross margin deleverage to be roughly in line with the year-to-date trends. We've had some questions on the guidance revision we provided a few weeks ago. Just to provide some additional context, the fiscal 2019 guidance we gave during our Q2 call in August embedded an inflection in trends particularly at Old Navy and the assumption that we would be entering the fourth quarter with a bit of momentum.

Given we did not see the inflection that we had hoped for materialize, we felt that a reduction to our guidance to better reflect current trends was prudent. Of course, however we're not pleased with our updated outlook, the organization remains focused on execution over the important holiday season and ending with improved momentum heading into 2020.

Now turning to third quarter financial performance. On a reported basis, our earnings per share was $0.37, excluding costs associated with our planned separation, and previously announced specialty fleet restructuring, our adjusted earnings per share were $0.53, $0.01 above our earlier guidance range due to timing capability in the closing process.

Regarding other key metrics, net sales for the quarter were $4 billion down 2% to last year. Comp sales were down 4% compared with flat last year. Rest of the quarter continues to be largely driven by new store openings at Old Navy and Athleta as well as non-comp Janie and Jack sales partially offset by Gap store closures.

As you saw the total sales accounts by division are in our press release. Third quarter gross margin was down 70 basis points to 39% an improvement from first half trends. While gross margin was in line with our expectations, the composition was slightly different, with Gap performing better and Old Navy performing worse than expected.

Merchandise margin was down 50 basis points primarily driven by Old Navy and Banana Republic partially offset by Gap brand and Athleta. Rent and occupancy deleveraged 20 basis points, primarily driven by lower net sales. Regarding SG&A on a reported basis, third quarter total operating expenses were $1.3 billion. When excluding costs associated with our planned separation and fleet restructuring, SG&A as a percentage of net sales deleveraged 70 basis points again primarily reflecting lower sales as well as increased expenses relating to technology investments.

Moving to taxes and interest, the effective tax rate was 33% in the third quarter, excluding the non-cash tax impacts related to restructuring charges, our adjusted tax rate was about two points lower. We now expect our full-year reported effective tax rate to be about 31%. Excluding current year adjustments to our fiscal year 2017 tax liability for tax reform guidance and certain non-cash tax impacts related to expected restructuring charges, we continue to expect our full-year 2019 effective tax rate to be about 26%. Regarding inventory, we ended the quarter with inventory up 2% compared to last year.

Excluding the impact of the Janie and Jack acquisition, store openings net of store closures and tariffs, inventory was down about 1% in line with previous guidance, as we continue to work around improving our overall inventory productivity.

While we've been more conservative in our inventory buys in the back half, there's more opportunity to better leverage core capabilities to eliminate waste in our buying processes, particularly given the challenging traffic trends.

We're pushing ourselves to buy less up front and keep more open on the back end. Brands are holding more open and over time this will allow us to be more nimble in the way we react to product trends and overall business performance. Also, as we said in September, the work to improve allocations based on Channel demand and localizing our assortment continues which over time is expected to increase yield, gross margin return on inventory and improve our working capital profile. We expect inventory levels to continue to decrease in Q4, while noting that in transit could cause fluctuations in this point in time metric.

Turning to cash flow, year-to-date free cash flow was $5 million, a decrease of $52 million over last year. We ended the quarter with $1.1 billion of cash, cash equivalents and short-term investments in line with our historical target of $1 billion to $1.2 billion. Year-to-date, capital expenditures were $523 million, including approximately $32 million of separation related capital.

We're up to near 2019 capital expenditure guidance to include separation related capital investments needed to facilitate the planned separation. We now expect fiscal 2019 capital expenditures of about $835 million. This is comprised of $575 million of base capital with priorities continuing to be focused and profitable growth opportunities at Old Navy and Athleta and investing prudently in technology and supply chain initiatives that position each of the future companies for sustainable growth, $160 million of separation capital investment primarily related to technology and logistics, and $100 million of expansion costs related to one of our headquarters building and a build-out of our Ohio Distribution Center.

Our overall philosophy around returning cash to shareholders has not changed. In addition to our quarterly dividends, we completed an additional $15 million of share repurchases during the third quarter and we expect to repurchase approximately $15 million in the fourth quarter as well. Year-to-date, we paid dividends of $274 million. Regarding store count, year-to-date, we added 85 Old Navy and Athleta stores on a net basis and acquired 140 Janie and Jack locations.

At Gap brand, we closed 21 stores primarily in North America, net of openings primarily in Asia. We ended the quarter with 3,938 company operated stores. We now expect 15 net store closures for the year as we accelerate the pace of openings in Athleta and completed some opportunistic openings of Gap outlets in China.

Before I open up the call for your questions, many of you already know that Tina Romani, or Head of Investor Relations will be moving on to a new opportunity outside of Gap, Inc. On behalf of the entire team, I want to express our gratitude for everything she has

On behalf of the entire team, I want to express our gratitude for everything she has brought to this role, her great technical ability but also her quick laughter and everything she's done for the company over the past seven years, she'll be missed.

I'd like to take this opportunity to welcome Katina Metzidakis, whose name I always stumble over, who will be assuming the Head of IR role. Katina has over a decade of experience primarily as a sell side analyst, and more recently in Investor Relations. She joined Gap, Inc. three months ago and working closely with Tina is off to a great start. Please join me in congratulating both of them and please reach out to Katina and the team on any investor communications going forward. So let me close by reiterating Bob's comments. We have a clear view of where our brands need to approve and appropriate clarity and urgency about the path forward. Our conviction on the opportunities remains strong. With that, we will open it up for questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question will come from Alex Walvis with Goldman Sachs.

Unidentified Analyst

Hello, this is [indiscernible] on for Alex, thanks so much for giving - for taking the time for a question. I was wondering if you could dive into Gap brand a little bit deeper, specifically by channel and geography. Can you help us break down trends between Gap stores and Specialty Gap outlet and then also if you had any impact from some of the disruption in Asia and Hong Kong this quarter?

Teri List-Stoll

Sure, as I said, the Gap brand had some bright spots in the quarter particularly as it pertains to the Denim initiatives that they had stated were going to be a priority for the brand. And so we were quite pleased with the performance of Denim really across channels and geographies. We don't disclose the specific results by channel but I would say that particularly in Specialty, we were pleased with the progress we saw overall.

We did definitely have some disruption in Asia. The Hong Kong situation is a very difficult situation and obviously had an impact on the business in that's part of our China business. And so we saw some challenges there. We also had some softness in Japan, which was a little bit of a product acceptance issue, but also some other macro factors that affected traffic overall in that geography.

So net-net as you look at it, as I said the progress we continue to see against margin rate is exactly what we think is a priority. Seeing the success in Denim when we bring together great product with great marketing and great in-store execution, does give us some optimism as we continue to drive that same formula across more categories and more channels. So still lots of work to do on the brand, but seeing some positive signs.

Unidentified Analyst

Great and if I could just ask one more as a quick follow-up regarding gross margins on your outlook for the fourth quarter, you're comping off of a relatively easy comparison for 4Q 2018. Can you help us understand some of the moving pieces and puts and takes by maybe brand and how you're thinking about the promotional structure with particular eye on how you're thinking about the Old Navy gross margin, given the performance hasn't been quite as good as you had previously thought it would be?

Teri List-Stoll

As I said on a year-to-date basis, most of our gross margin challenge has come from the Old Navy brand, and we've actually had some positive from Gap, particularly in the third quarter. The expectations for those two brands actually came out different than we expected. And so as we move into Q4 and particularly with the revision in guidance we've made, what we've acknowledged is that the trends we have been seeing have not yet inflected. And that's why we provided the guidance that would say Q4 margin is going to be fairly consistent with what we have seen year-to-date and it's the same primary factors driving it, which is largely Old Navy. Again, as we said, it's early days for holiday. So a lot can happen. But that's our current view.

Unidentified Analyst

Great. Thank you so much.

Operator

And our next question comes from Randy Konik with Jefferies.

Randy Konik

Thanks a lot. I guess Teri just following up on margins, you gave us perspective that the gross margins for Gap had been up, it sounds like for three quarters in a row, which means that Old Navy gross margins has been down. If you look at the annual guidance you've given us, what does that imply for the segment margin of Old Navy on an annual basis for the end of this year? And I guess the question we're all trying to get towards is what would -- what starts to kind of stabilize those operating margins or segment margins in Old Navy and when? That's my first question. Thanks.

Teri List-Stoll

Yes, so I think what you can anticipate is that there is meaningful margin degradation in the Old Navy brand on a fiscal year basis at the segment level. And we will likely provide some additional detail with that as we close out the fiscal year. But what will really need to happen in order to address that is for us to see some of the benefits of the actions we've taken with regard to product, particularly the women's product. And then as we continue to buy leaner, we bought quite a bit leaner in the back half of the year as we've talked about, but the traffic drag has done a little bit worse than expected.

So we're still not where we want to be and as we've leaned into Q1 and Q2, we've tried to balance the fact that the product will continue to get better with the changes we've made, but also recognizing that same traffic lag, so I would expect the combination of improved products as we move through Q4 into Q1 as well as the strengthened marketing plans that we put in place and will sustain as we move into Q1 and then the leanness of the inventory should give us a little more margin leverage.

Randy Konik

Helpful and can I just maybe ask a question for Bob, I guess Bob since we don't get you on the call that often, I just want to get your personal perspective or view of what you think the future of the Gap brand should look like or look differently from what was being previously pursued under Art. Just want to get some of your thoughts there and just expand upon what type of quality or different qualities you might be looking for from the new leader going forward? Thanks.

Robert Fisher

Yes, look I'm objective about the performance of the brand and realize that significant improvement is required. There is a lot of transformation work that is going on and will continue with urgency. We really looked at the separation as a catalyst for reimagining the operating models, the process, the culture, our focus is going to be on improving the profitability of the brand. We need more standardized processes, that's better leveraging of our investments in systems and capabilities, adopting a stronger culture of accountability. We're looking at a common operating platform and a more focused investment choices. Those are critical for us.

Regarding the CEO search, we got talented leaders in place who are looking at their businesses and taking the necessary actions. As the Board looks at potential successors, its focus will be on leadership candidates with operational excellence that can drive greater efficiency, speed and profitability in a creative environment. We are a mixture here of left and right brained. And so far as you find that, that's important.

Randy Konik

Very helpful. Thank you.

Operator

[Operator Instructions] Your next question comes from the line of Matthew Boss with JPMorgan.

Matthew Boss

Thanks, great. So as we kind of break this down, what would be the outlook for comps by brand in the fourth quarter relative to performance that you saw in the third quarter, and then at Old Navy maybe larger picture, where on the women's side do you see the biggest challenge with the product assortment currently. And what do you think is the timeline to turn that business?

Teri List-Stoll

Yes, so we haven't broken down comp by brand as we think about the guidance, we've given for Q4, I think what we have said is that, that we weren't, we weren't thrilled with the Banana performance on the quarter and obviously, some of that was just timing of product flows relative to fall.

So hopefully we will see some positive inflection there. But for Gap and Old Navy, we’re not anticipating a major turn versus what we've seen. With regards to the Old Navy product issues in women's, we've talked about it a bit, it has tended to be a bit of a combination of factors in terms of some of the silhouettes and the prints and patterns that that we just kind of missed and we lost sight of what our consumer really valued, it was a little bit exacerbated by some of the broader trends in the market not being necessarily democratic but and is relative to our own customer needs.

And so and then obviously as we have challenges in women's product that does cast a bit of a shadow over the rest of the business because our primary customer is the mom, the woman and when she comes into the store and doesn't find something that she loves, it obviously affects her willingness to shop, men's and kids, babies. So we've been very much focused on is we have strengths in the business in Denim and Fleece and Active. And so as we lean into those for fall, that does give us a little bit of a bridge as we continue to drive the improvement in women's products.

I think the sense of [indiscernible] come in to that business from Athleta is that we're making real good headway. We understand the issues, and we will continue to see progress there, not saying about what we're seeing has any reflection on our long-term opinion of the strength of the brand, or the growth prospects of the brand, it really is very much product issues, which has led to some traffic pressures. And we're working our way through it through it.

Matthew Boss

Great, and then just one follow-up on the margin front as we think about expenses, Teri what's the best way to think about Gap versus Old Navy as we think about balancing marketing, wages and investments against some of the outlined efficiency opportunities more as we think beyond this year for the Gap and Old Navy?

Teri List-Stoll

Yes, just make sure I'm answering your question. So let me take a shot at it and then tell me if I have hit the mark. But our priority today and our priority even leading up to in post separation will be to ensure that we're allocating sufficient investment to the growth prospects of Old Navy and Athleta. So we're going to make that a priority to ensure they're both stood up for success against their respective strategic priorities.

The Gap brand, we are investing behind the brand, but very thoughtfully, intentionally. So for example in Q4, we will have a little more marketing investments frankly across all of the brands, because it's an important season as you know and to the extent we have had traffic pressures, we need to be able to invest in engaging our customers to drive more frequency to acquire new customers to just ensure we're getting the foot traffic across both stores and in online. So we will be investing in all of the brands but with a definite distortion to fixing Old Navy and continuing to support the growth of Athleta.

Matthew Boss

That's great color. Thank you.

Operator

And our next question will come from Mark Altschwager with Baird.

Mark Altschwager

Good evening. Thanks for taking my question. Teri, maybe just following-up on that last line of discussion. So I meant at Old Navy, it sounds like women's is still an issue. But you do have you're seeing some positive trends in other areas of the assortment that perhaps over index over holiday if I heard that correctly. And it also sounds like marketing, it's over index, over holiday if I heard that correctly. And it also sounds like marketing, it's been identified as an opportunity and you are investing more heavily in that marketing in the fourth quarter. So I guess if I have those two things correct, why not more sequential improvement in that comparison in the fourth quarter, I guess the down mid single digit guidance, it seems to presume that trends don't get much better despite the easier comparison. So I'm trying to reconcile all that things?

Teri List-Stoll

Yes, no, no, it's a fair question. And maybe it's just while we're leaning into Denim, Fleece and Active, I don't think that that can offset some of the challenges we have in women's partly for the reason I described that is the women's product isn't drawing her in and starting her shopping. It does have impact on the other categories as well. But definitely, particularly even in holiday even though we'll be having, we have Jingle Jammies which is a great promotion for the brand and we have other things going on.

At the end of the day, if we're not strong in dresses and woven and the things that she wants to buy for holiday, that's going to have a bit of an impact. Now, in fairness, we've been working at this and we have seen some positive trends, we've seen over the last few weeks, some positive sales over traffic. There are some indicators that that are been encouraging, as I said but we remain cautiously optimistic given how early it is. And we would like nothing more than to be able to come out of holiday and tell you that we saw the inflection, we had originally been hoping for. We just -- it’s just premature for us to call that today.

Mark Altschwager

Thank you.

Operator

And moving on to Oliver Chen with Cowen and Company.

Oliver Chen

Hi, thank you and congrats Tina and Katina. Bob and Teri would love your thoughts on the state of the store base and how you're thinking about the lower productivity Gap stores and what may happen there because we're cautious on traffic trends being under pressure there and the future as well. And also on the broader topic of speed and cyber platforming and your thoughts on changes that can be made to the business, that's been a journey for you in terms of that has been an area of focus, would love your thoughts on what's ahead? Thank you.

Robert Fisher

Yes, I guess given I've been here in the seat two weeks, I'm going to let Teri take that one. But I appreciate you're asking me.

Teri List-Stoll

And I'm happy to start with and Bob may have something to add, because Bob and I spent some time this morning even talking to one of our landlords about, about the stores and this is, this is an important part of our transformation of really the specialty business, but particularly the specialty business in the Gap brand. And we have acknowledged with our fleet restructuring program, that we still have too many stores that are oversized, not performing the way we need to need them to perform, maybe in locations that are no longer on her path that aren't driving the profitability that we need.

And so it's critical that we get our store face down to the appropriate number of stores with the appropriate level of profitability is where we actually have the ability to invest in the stores. I mean, Bob can share his experiences over the years but it's clear that a lot of our stores are oversized, a lot of stores haven't been invested in to provide a differentiated experience to our customers.

So we're very, very much focused on getting to the right store base. Now, the flip side is specialty of course is on the outlet side and the factory side for Banana, the value of space is certainly more attractive. It has store economics, not unlike Old Navy with nice margins and lower rod and those in fact have opportunity to certainly perform better but obviously more financially attractive from the get go. And we are continuing to look at how we drive those and could potentially even add stores there over time, as the business turns.

Robert Fisher

You also asked a question about speed. This has been a long, slow journey to speed. And it's not anything that I'm terribly proud of, I think we can do a lot better. And I think we have to look at the entire way we design, develop, sample, source, and distribute product and get into the 21st century.

Teri List-Stoll

This is one where we have invested in a lot of capability. And so what we really need to drive adoption of some of the capabilities that we do have and it does take some intentional planning and operational discipline, you have to platform the fabrics, you have to take some best in some cases, and importantly you have to leave yourself open on inventory to be able to

respond to learnings you have on both demand and trends. And so that is an area we need to continue to exploit because we've already invested in the capabilities.

Oliver Chen

Thank you.

Robert Fisher

Until our turns are better than average, we can do better.

Teri List-Stoll

Next question?

Operator

Certainly, our next question will come from Westcott Rochette with Evercore ISI.

Westcott Rochette

Thanks a lot guys. Going back to Old Navy, you've obviously built-up a lot of goodwill with the customer over time as a value fashion oriented. Are you seeing signs that that customer is still seeking you out and looking and just not happy moving on whether it's online as a pre-shop things that are showing that the customer is still looking and you can easily kind of win them back and thinking about that there's a value oriented, off-price retailer to sit at 10% like a parallel comp. Do you think that customer to this kind of migrating to other places right now, but you find that you can pull them back? Thank you.

Teri List-Stoll

Yes, it's a really fair question. And obviously, the competition in the value space is very strong. We've seen some of our best competitors do very well during this time where we've been challenged with some of our own operational issues. But when we look at the fundamental measures of brand health, we still feel very good about our share levels, the menus share, the brand health that we look at from a YouGov standpoint, which is a measuring service we use, our NPS scores as we look at experiences of customers in our stores.

These are all positive indicators. And so I think to quickly answer your question, we very much do believe that our customers is still engaged, and that as we tailor our promotional activities, our marketing activities and continue to return to delighting her with our product offerings, that the customer engagement will be as strong as it's ever been.

Robert Fisher

There's no question that some of the competition is getting better. But this is still a very highly fragmented industry with fluid shares. And when you have that and you perform, you should be able to grow share.

Westcott Rochette

Excellent. And can you just provide or give an update on what your digital sales are whether the activity in the digital is significantly different than what you're seeing in-store? Thank you very much.

Thank you very much.

Teri List-Stoll

Yes, across the board, our online trends are better than our store trends. And in fact, in our growth trends at Old Navy and Athleta the quarter had double-digit growth in online, Athleta is actually about half online given its heritage and still posting double-digit growth there. So there is a definite spread there. And that's, that's really what we're focused on is how do we create seamless experiences for our customers, so that digital is embedded and seamless for them, so that we can capture them wherever they shop, and wherever they buy, which tend to be not necessarily the same place. And so we were pleased with the progress we're seeing in our online business, but also see that as a continued opportunity for growth as we move forward.

Westcott Rochette

Thank you. Good luck.

Teri List-Stoll

Thank you.

Operator

And moving on to Kimberly Greenberger with Morgan Stanley.

Kimberly Greenberger

Great, thank you so much for taking the question. Bob, I wanted to just get your perspective and Teri yours as well. We're trying to understand from the outside, it's a little more difficult. The what it is about the organization that prevented Gap discretely and separately from Old Navy from focusing on each of their respective customers and having a differentiated strategy because as we understand it from the outside, there's these are completely separate organizations. They have a different staff in each brand. And so we're just trying to figure out what was it about these two businesses being in the same organization that sort of prevented that separate individual focused on each of their customers that you think can be addressed and fixed through the separation?

Robert Fisher

Sure. The fundamental business models are different from between the two, the two businesses between the Gap, Inc. portfolio which sells about 425 million units a year but produces over 35,000 styles. So that's 12,000 units for style. Old Navy is we talked about it here as machine, it's a units business. It operates on a different scale than the brands in the Gap, Inc. portfolio, it sells 700 million units a year, concentrated in 9,700 styles, that's about 70,000 units of style. It's an $8 billion brand and operates at the intersection of value and specialty. And it's in order to have a specially focus, I think we need to have everything aligned around I'm sorry, in order to have the value focus, we need to have everything aligned around value. And that's not the way the other brands are.

Teri List-Stoll

And Bob maybe I would just add that that there are -- there's friction whenever you have a portfolio and even though the brands are run separately and Sonia very much today is focused on the growth of Old Navy in terms of day to day execution.

When it comes down to capital allocation or even how we might roll-out initiatives that are beneficial to all brands, but for whatever reason, the timing may be influenced by the needs of one brand over another.

There's just a number of places within the portfolio where the friction affects the speed and ability of Old Navy to be able to be singularly focused on both the capital allocation and operational choices that would allow it to win in this highly competitive values.

Kimberly Greenberger

Great, that's really helpful. Teri, I just had one quick follow-up for you on the capabilities. When Bob talked about, not proud of the performance on the long, slow journey to speed. You mentioned that you've invested in a number of capabilities, but perhaps they're not being utilized. Could you just remind us what are a couple examples of those capabilities?

Teri List-Stoll

Yes, there has been a number of tools that are a function of the overall speed model, whether it's testing or whether it's use of data science and some of our inventory planning. There's just a number of places within our -- what we call our PEES, which is our Product

There's just a number of places within our -- what we call our PEES, which is our Product End-to-End System, where we built in capability that hasn't been fully utilized. Some of it also as I said, just planning, it takes a different level of discipline to be able to get the benefit of speed model. And then the last part is co-creation where we have not ramped-up our co-creation capabilities with vendors as much as we have, as we would have expected. We invest in those relationships. We have some very sophisticated vendors, but we haven't fully exploited what they can bring to the party in terms of co-creation, which also can help with speed.

Kimberly Greenberger

Great, thank you.

Operator

And our last question will come from the line of Dana Telsey with Telsey Advisory Group.

Dana Telsey

Bob, you've lived with The Gap, Inc. as your whole life and separation has been a topic in the past never obviously is foremost now. And given the current dislocation in the retail market, and in the retail market and what you see for the different brands, how do you look at, do you see any acceleration of timing of them being standalone, and is the timing for the separation still Spring of 2020 or February 2020. And Teri given the changes going on in terms of what you're seeing. Athleta I think there was a little bit of a hiccup in this quarter, anything that we should watch in terms of the people side, given the changes going on that could accelerate or hinder progress as we move through 4Q? Thank you.

Teri List-Stoll

Dana, there are lot of questions in there. We will take a shot and then make sure we’ve gotten them off.

Robert Fisher

We did a thorough review of the strategic tenants underlying the separation as well, the operational and execution of plans. We remain confident in the value creation opportunities, it presents inclusive of our current business, current view on business and the expected cost of the transaction. We're looking at mid-year for the transactions, and but we're going to, the planning and the execution of this is complicated and people are working really hard heads down.

Fortunately, much of the work goes on in the more corporate functions. I've been really very pleased that I don't see a tremendous amount of distraction going on in the brands, which are the ones critical to execute holiday and beyond. And yes, it was a -- it was a difficult decision but at some point parents let their children leave the house and go out and do great things. So I think that was the conclusion we can give.

Teri List-Stoll

And Dana, I think you asked about effectively talent retention is that's the last part of your question?

Dana Telsey

Exactly.

Teri List-Stoll

Yes, this is one where, this is a year of change. And it's a year of business challenges and obviously, that that can create more work for everyone in the organization. And so you have some risks. But I do think in many respects, particularly even over the last few weeks, as we work through the leadership transitions, I think there's renewed optimism about our ability to have the clarity of the path forward and make the decisive, take the decisive actions that support that strategy and have a sense of urgency in driving the transformation and setting both companies up for success. So I think that employees are energized by that, and we can already start to feel it in the building today.

Dana Telsey

Thank you, best of luck.

Teri List-Stoll

Thank you

Thank you.

Operator

Thank you. That does conclude our conference. You may now disconnect.