

# Corporate Credit > U.S. Investment Grade



## The Gap (GPS)

Updated: November 2, 2015

### Trade Idea:

- ▶ Buy Gap 5-year bond.

### Investment Rationale:

- ▶ S&P revised the outlook on the Gap (GPS) BBB- rating to negative (from stable). Rationale for the action was mainly the announcement that the head of the Old Navy brand, Stefan Larsson, is leaving to become the CEO of Ralph Lauren. Old Navy has been GPS' best performing brand and has been supporting the GAP and Banana Republic brands. S&P believes there is a 33% chance it would lower the rating within the next 12 to 24 months if the operating trend in those brands does not improve.
- ▶ From a credit perspective, the fact that the S&P rating could possibly go to HY raises a concern. However, with a probability of a rating action only 33% within the next 1 to 2 years, we think there is ample time for the company to stabilize its performance. As we mentioned in our last update, we think the credit profile is currently strong for the rating level; however, it is a necessary cushion to insulate the company from the challenges of foreign currency fluctuations, weak retail margins, fast inventory obsolescence and competition in the retail fashion industry.
- ▶ It appears that spreads on GPS bonds are quoted about 20 bps to 30 bps wider. We think this may be a bit of an overreaction since S&P put the downgrade probability at 33% over a 1 to 2 year period. In addition, we think any negative headline in the current weak bond market may cause some exaggerated spread movement. Nonetheless, the risk is worth noting. In our view, we still view GPS as a stable low-BBB name and continue to see value in the bonds, especially at the wider levels.

### Recommendation(s):

View	Trade Horizon	Ticker	CPN	Maturity	Ratings		CCY	Issue Size (mm)	Yield	Spread			Cash Price	ISIN
					S&P	Moody's				Entry	Target	Loss		
Outperform	6-12 months	GPS	5.95	4/12/2021	Baa3	BBB-	USD	1,250	4.58	301	261	341	106.27	US36476 OAK48