

Management's Discussion and Analysis

Results of Operations

Net sales for the fourth quarter of 1997 grew 10% to \$3.268 billion from \$2.966 billion for the same period a year ago. Net income was \$85.3 million versus \$213.4 million in the fourth quarter of 1996, and earnings per diluted share were \$.31 versus \$.78 in the fourth quarter of 1996. Excluding special and nonrecurring items and inventory liquidation charges associated with the closing of five Henri Bendel stores, net income was \$252.5 million versus \$220.2 million in the fourth quarter of 1996, and earnings per diluted share were \$.91 versus \$.81 in the fourth quarter of 1996.

As a result of an ongoing review of the Company's retail businesses and investments as well as implementation of initiatives intended to promote and strengthen the Company's various retail brands (including closing businesses, identification and disposal of non-core assets and identification of store locations not consistent with a particular brand) during the fourth quarter of 1997, the Company recognized total charges of \$289 million (approximately \$30 million after-tax cash impact) or \$.60 per diluted share, consisting of \$276 million in special and nonrecurring charges and a \$13 million cost of sales charge for inventory liquidation at Henri Bendel. These charges included:

- A \$68 million charge for closing the 118 store Cacique lingerie business effective January 31, 1998. The amount includes \$38 million in cash charges relating to cancellation of merchandise on order and other exit costs such as severance, service contract termination fees and lease termination costs;
- \$95 million in charges related to Henri Bendel, which include an \$82 million special and nonrecurring charge related to streamlining Henri Bendel from six stores to a one-store operation by September 1, 1998. The amount includes \$56 million in cash charges that are recorded in other current liabilities. In addition, the Company incurred a \$13 million cost of sales charge for inventory liquidation. The charge to cost of sales is in accordance with Emerging Issues Task Force ("EITF") Issue No. 96-9, "Classification of Inventory Markdowns and Other Costs Associated with a Restructuring";
- \$86 million of impaired asset charges related principally to the women's apparel businesses, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." This charge has no cash impact but is an SFAS No. 121 required accounting adjustment to measure the fair value of store assets, and will provide a noncash benefit in future periods from reduced depreciation and amortization;
- A \$28 million provision for closing or downsizing approximately 80 oversized stores, primarily in the Limited, Lane Bryant, Lerner New York and Express women's businesses, and a \$12 million write-down to net realizable value of a real estate investment previously acquired in connection with closing and downsizing certain stores.

Net sales for the fiscal year ended January 31, 1998, increased 6% to \$9.189 billion from sales of \$8.645 billion for the same period ended February 1, 1997. Net income was \$217.4 million, or \$.79 per diluted share, compared to \$434.2 million, or \$1.54 per diluted share last year.

Excluding the impact of special and nonrecurring items, gains in connection with initial public offerings ("IPO"), and the Henri Bendel inventory liquidation charges, the Company would have earned \$1.24 per diluted share compared to last year's \$1.14. These excluded items consisted of: 1) \$213.2 million related to the previously described fourth quarter charges that was net of a third quarter net gain of \$62.8 million related principally to the sale of approximately one-half of the Company's investment in Brylane, Inc. ("Brylane"), a 26% owned (post-IPO) catalogue retailer; 2) in 1997, a pretax gain of \$8.6 million in connection with the IPO of Brylane; 3) \$12 million of special and nonrecurring charges in 1996 related to the April 1997 sale of Penhaligon's; and 4) in 1996, a gain of \$118.2 million resulting from the Abercrombie & Fitch ("A&F") IPO.

Business highlights for 1997 include the following:

- Intimate Brands, Inc. ("IBI"), led by strong performances at Bath & Body Works and Victoria's Secret Stores, recorded earnings per diluted share of \$1.14, compared to \$1.02 in 1996, including special and nonrecurring charges of \$.16 in 1997 and \$.03 in 1996.
- A&F delivered 1997 earnings per diluted share of \$.94, a 74% increase over 1996 as comparable store sales increased 21% on top of 13% for 1996.
- However, much of the gains from IBI and A&F were offset by a decline in operating income for each of the women's businesses, which finished the year with a pretax operating loss aggregating \$268 million, including special and nonrecurring charges of \$187 million and the \$13 million inventory liquidation charge related to the closing of five Henri Bendel stores.
- Limited Too led the emerging businesses with a significant improvement in operating income and 20% comparable store sales gains.
- During the year, the Company also completed the sales of its interests in the Newport Office Tower in Jersey City, New Jersey, and The Mall at Tuttle Crossing in Columbus, Ohio, and approximately one-half of its interest in Brylane for cash proceeds of \$343.2 million.
- On February 17, 1998, a registration statement was filed with the Securities and Exchange Commission in connection with a plan to establish A&F as a fully independent company via a tax-free exchange offer pursuant to which The Limited shareholders will be given an opportunity to tender some or all of their shares of The Limited in return for shares of A&F. The transaction is subject to certain customary conditions.
- On February 20, 1998, the Company entered into a definitive agreement with Pinault Printemps-Radoute to sell its remaining 2.6 million shares of Brylane for \$51 per share, generating net cash proceeds of \$131 million. The transaction is expected to close in the first quarter of 1998.

The Company does not believe that the consummation of the transactions and the taking of the other actions outlined above will have a material effect on the Company's liquidity (i.e., its ability to provide the resources to support operations, projected growth, seasonal requirements and capital expenditures). Furthermore, although the Company believes that such transactions and other actions should have a favorable impact on the Company's results of operations, there can be no assurance with respect to the effect of these actions.

The following summarized financial data compares 1997 to the comparable periods for 1996 and 1995 (millions):

	1997	1996	1995	% Change	
				1997-96	1996-95
NET SALES					
Express	\$1,189	\$1,386	\$1,445	(14%)	(4%)
Lerner New York	946	1,045	1,005	(9%)	4%
Lane Bryant	907	905	903	—	—
The Limited	776	855	850	(9%)	1%
Henri Bendel	83	91	91	(9%)	—
Total Women's Brands	\$3,901	\$4,282	\$4,294	(9%)	—
Structure	660	660	576	—	15%
Limited Too	322	259	214	24%	21%
Galyan's Trading Co. (since 7/2/95)	160	108	45	48%	n/m
Other	6	4	—	n/m	n/m
Total Emerging Brands	\$1,148	\$1,031	\$835	11%	23%
Victoria's Secret Stores	1,702	1,450	1,286	17%	13%
Victoria's Secret Catalogue	734	684	661	7%	3%
Bath & Body Works	1,057	753	475	40%	59%
Cacique	95	88	80	8%	10%
Other	30	22	15	n/m	n/m
Total Intimate Brands	\$3,618	\$2,997	\$2,517	21%	19%
Abercrombie & Fitch	\$522	\$335	\$235	56%	43%
Total Net Sales	\$9,189	\$8,645	\$7,881	6%	10%

OPERATING INCOME

	1997	1996	1995	% Change	
				1997-96	1996-95
Women's Brands	Ⓐ \$(268)	\$64	Ⓔ \$54	n/m	19%
Emerging Brands and Other	Ⓒ 159	68	Ⓓ 149	134%	(54%)
Intimate Brands	Ⓒ 505	Ⓓ 458	386	10%	19%
Abercrombie & Fitch	84	46	24	83%	92%
Total Operating Income	\$480	\$636	\$613	(25%)	4%

Ⓐ 1997 includes special and nonrecurring charges of approximately \$187 million relating to the closure of five out of six Henri Bendel stores and charges associated with asset valuation impairment and the closure and downsizing of certain stores, plus \$13 million in inventory liquidation charges associated with the Henri Bendel closings.

Ⓑ 1997 includes \$42 million of special and nonrecurring income relating to the gain from the sale of approximately one-half of the Company's interest in Brylane, offset by a valuation adjustment on an investment.

Ⓒ 1997 includes a \$68 million charge related to the closing of the Cacique business effective January 31, 1998.

Ⓓ 1996 includes a special and nonrecurring charge of \$12 million for revaluation of certain assets in connection with the sale of Penhaligon's in April 1997.

Ⓔ 1995 includes a special and nonrecurring charge of approximately \$48 million, primarily for store closings and downsizings.

Ⓕ 1995 includes 100% of WFNNB's operating income of \$114 million before interest expense versus \$4 million, representing 40% of net income of \$11 million in 1996; 1995 also includes an approximate \$73 million gain from the sale of a 60% interest in WFNNB, partially offset by \$23 million of special and nonrecurring charges representing write-downs to net realizable value of certain assets.

n/m not meaningful

The following summarized financial data compares 1997 to the comparable periods for 1996 and 1995:

	1997	1996	1995	% Change	
				1997-96	1996-95
COMPARABLE STORE SALES:					
Express	(15%)	(6%)	(2%)		
Lerner New York	(5%)	8%	(1%)		
Lane Bryant	1%	0%	(8%)		
The Limited	(7%)	3%	(4%)		
Henri Bendel	(13%)	(5%)	6%		
Total Women's Brands	(8%)	0%	(3%)		
Structure	(3%)	7%	(9%)		
Limited Too	20%	8%	(4%)		
Galyan's Trading Co. (since 7/2/96)	0%	12%	—		
Total Emerging Brands	3%	7%	(8%)		
Victoria's Secret Stores	11%	5%	(1%)		
Bath & Body Works	11%	11%	21%		
Cacique	10%	8%	(20%)		
Total Intimate Brands	11%	7%	1%		
Abercrombie & Fitch	21%	13%	5%		
Total Comparable Store Sales Increase (Decrease)	0%	3%	(2%)		

STORE DATA:

	1997	1996	1995	% Change	
				1997-96	1996-95
Retail Sales Increase Attributable to New and Remodeled Stores	6%	8%	9%		
Retail Sales per Average Selling Square Foot	\$295	\$285	\$272	4%	5%
Retail Sales per Average Store (thousands)	\$1,478	\$1,453	\$1,419	2%	2%
Average Store Size at End of Year (selling square feet)	5,035	5,043	5,172	—	(2%)
Retail Selling Square Feet at End of Year (thousands)	28,400	28,405	27,403	—	4%

NUMBER OF STORES:

	1997	1996	1995
Beginning of Year	5,633	5,298	4,867
Opened	315	470	504
Acquired (Sold)	(4)	—	6
Closed	(304)	(135)	(79)
End of Year	5,640	5,633	5,298

Net Sales

Fourth quarter 1997 sales as compared to sales for the fourth quarter 1996 increased 10% to \$3.268 billion due to 5% comparable store sales gains with the balance of the increase attributable to new and remodeled stores and increased catalogue sales. Thirteen-week fourth quarter 1996 sales as compared to sales for the fourteen-week fourth quarter 1995 increased 7% to \$2.966 billion due to a 9%

increase in sales attributable to new and remodeled stores and a 3% increase in comparable store sales, offset by a 5% decrease due to the fifty-third week in 1995.

The 1997 retail sales increase of 6% was attributable to the Company adding 315 new stores, remodeling 206 stores and closing 186 stores (excluding closing 118 Cacique stores in January 1998 and the sale of four Penhaligon's stores in the first quarter of 1997). This net addition of 129 stores represents over 365,000 square feet of new retail selling space. For the year, average sales productivity increased 4% to \$295 per square foot.

In 1997, IBI accounted for 114% of the Company's total net sales increase and 39% of total Company sales. IBI posted a \$620 million sales gain over the prior year due to the net addition of 223 stores (before the impact of the Cacique store closings and the Penhaligon's sale) representing over 650,000 new retail selling square feet, an 11% increase in comparable store sales and an 18% increase in catalogues mailed by Victoria's Secret Catalogue. Additionally, A&F reported a \$186 million sales increase over the prior year, bolstered by a 21% increase in comparable store sales, while Limited Too experienced a \$63 million sales increase over the prior year on a 20% increase in comparable store sales. However, sales at the women's businesses in 1997 declined \$382 million from 1996, primarily due to an 8% decrease in comparable store sales, as well as a net decrease of 131 stores representing over 705,000 retail selling square feet, due principally to closures of underperforming locations.

The 1996 retail sales increase of 10% was attributable to an 8% increase in sales due to the Company adding 470 new stores, remodeling 252 stores and closing 135 stores, and a 3% increase in comparable store sales, offset by a 1% decrease due to the fifty-third week in 1995. This net addition of 335 stores represents approximately 1 million square feet of new retail selling space. For the year, average sales productivity increased 5% to \$285 per square foot.

In 1996, IBI accounted for 63% of the annual sales increase, and nearly 35% of total Company sales, posting a \$480 million sales increase over the prior year due to the net addition of 316 stores representing over 817,000 selling square feet, a 7% increase in comparable store sales and an 11% increase in catalogues mailed by Victoria's Secret Catalogue. Sales at the women's businesses in 1996 were flat to 1995, primarily due to flat comparable store sales. Disappointing results at Express, which experienced a 6% decline in comparable store sales, were offset by improved results at the Lerner New York and Limited businesses, which had 8% and 3% increases in comparable store sales. In addition, the overall sales increase for the Company included sales increases at Structure, A&F and Limited Too, which experienced 7%, 13% and 8% increases in comparable store sales.

Gross Income

Gross income increased to 35.4% as a percentage of sales for the fourth quarter 1997 from 33.0% for the fourth quarter 1996. The merchandise margin rate (representing gross income before deduction of buying and occupancy costs), increased 2.3%, expressed as a percentage of sales, due principally to improved initial markup ("IMU"), which was partially offset by a slightly higher markdown rate and the \$13 million Henri Bendel inventory liquidation charge (.4% of sales). Buying and occupancy costs, expressed as a percentage of sales, were flat for the fourth quarter as compared to last year.

Gross income, expressed as a percentage of sales, was 33.0% for the fourth quarter 1996 compared to 29.2% for the fourth quarter 1995. The merchandise margin rate increased 3.4%, expressed as a percentage of sales, due principally to improved IMU and lower markdown rates, as the Company was less price-promotional than the year before. Buying and occupancy costs decreased .4%, expressed as a percentage of sales, primarily due to sales productivity associated with the 3% increase in comparable store sales.

The Company's 1997 gross income rate increased 1.8% to 30.7% as compared to 1996. The merchandise margin rate increased 1.7% due principally to improved IMU, while buying and occupancy costs, expressed as a percentage of sales, were flat to last year.

The 1996 gross income rate of 28.9% increased 2.4% as compared to 1995. Merchandise margins, expressed as a percentage of sales, increased 1.7%, due principally to improved initial markup. Buying and occupancy costs decreased .7% expressed as a percentage of sales, primarily due to sales productivity associated with the 3% increase in comparable store sales.

General, Administrative and Store Operating Expenses

General, administrative and store operating expenses increased to 20.8%, expressed as a percentage of sales, in the fourth quarter of 1997, compared to 18.7% in the fourth quarter of 1996. This increase was attributable to: 1) a 2.5% rate increase at the IBI businesses (discussed below) combined with an increase of IBI sales in the total Company mix to 42.7% from 39.1%; 2) the inability to leverage these expenses at the women's businesses due to disappointing sales performance; and 3) additional compensation charges for restricted stock plans.

IBI's increase is primarily the result of advertising costs at Victoria's Secret Stores, the growth of Bath & Body Works in the overall mix of IBI net sales from 25.1% in fiscal 1996 to 29.2% in fiscal 1997 and an increase in restricted stock plan compensation expense. Due to an emphasis on point-of-sale marketing and sales floor coverage for personal care products, Bath & Body Works has higher store operating expenses as a percentage of net sales, which has been more than offset by higher gross margins.

The Company anticipates that these expenses, expressed as a percentage of sales, will increase slightly in 1998, since the IBI businesses, in particular Bath & Body Works, will represent a greater portion of total Company sales.

General, administrative and store operating expenses, expressed as a percentage of sales, increased to 18.7% in the fourth quarter of 1996 compared to 17.7% in the fourth quarter of 1995. This

increase as a percentage of sales was attributable to a 2.2% rate increase at the IBI businesses and the inability to leverage expenses due to disappointing sales performance at the women's businesses, particularly Express.

General, administrative and store operating expenses increased, expressed as a percentage of sales, to 23.1% in 1997, compared to 21.4% in 1996. This increase was primarily attributable to the reasons discussed above for the 1997 fourth quarter. These costs increased, expressed as a percentage of sales, to 21.4% in 1996 compared to 20.0% in 1995, also primarily due to reasons discussed above for fourth quarter 1996.

Special and Nonrecurring Items

As described in Note 2 to the Consolidated Financial Statements, the Company recognized special and nonrecurring charges of \$276 million during the fourth quarter of 1997 comprised of: 1) a \$68 million charge for the closing of the Cacique lingerie business effective January 31, 1998; 2) an \$82 million charge related to streamlining the Henri Bendel business from six stores to one store; 3) an \$86 million impaired-asset charge in accordance with SFAS No. 121, related principally to the women's apparel businesses, covering certain store locations where the asset carrying values are permanently impaired; and 4) a \$28 million provision for closing and downsizing approximately 80 oversized stores primarily within the Limited, Lerner New York, Lane Bryant and Express women's businesses and for a \$12 million write-down to net realizable value of a real estate investment previously acquired in connection with closing and downsizing certain stores. Additionally, the Company recognized a \$13 million charge to cost of sales in the fourth quarter of 1997 for inventory liquidation in accordance with EITF Issue No. 96-9. The Company, in accordance with EITF Issue No. 94-3, anticipates charges for severance and other associate termination costs for Henri Bendel in the first quarter of 1998 (the period the associates are notified). Additionally, the Company recognized a net \$62.8 million pretax gain during the third quarter of 1997 relating to the sale of approximately one-half of its investment in Brylane, partially offset by valuation adjustments on certain assets where the carrying values were permanently impaired.

In 1996, the Company recorded a \$12 million pretax, special and nonrecurring charge in connection with the 1997 sale of Penhaligon's, a U.K.-based subsidiary of IBI.

In the fourth quarter of 1995, the Company recognized a \$73.2 million pretax gain in connection with the sale of a 60% interest in the Company's wholly-owned credit card bank, World Financial Network National Bank ("WFN"). In addition, the Company recognized a special and nonrecurring charge during the fourth quarter of 1995 of approximately \$71.9 million. Of this amount, \$25.8 million was provided for the closing of 26 stores and \$19.8 million was provided for the downsizing of 33 stores, primarily at Limited and Lerner New York. The remaining charge of approximately \$26.3 million represented the write-down to market or net realizable value of certain assets arising from nonoperating activities. The net pretax gain from these special and nonrecurring items was \$1.3 million.

Operating Income

Fourth quarter operating income, expressed as a percentage of sales, was 6.1% in 1997, compared to 13.9% in 1996, and for the year was 5.2% in 1997 compared to 7.4% in 1996. Excluding charges for special and nonrecurring items in both years and the Henri Bendel inventory liquidation charge in 1997, fourth quarter operating income, expressed as a percentage of sales, would have been 15.0% in 1997 compared to 14.3% in 1996, and for the year would have been 7.7% in 1997 compared to 7.5% in 1996. These increases were due to increases in the gross income rate, which more than offset the general, administrative and store operating expense rate increase.

The fourth quarter operating income rate increased 2.4% in 1996, from 11.5% on an adjusted basis in 1995, and for the year increased .9% in 1996 from 6.5% on an adjusted basis in 1995. The 1995 rates were adjusted to reflect the 1995 sale of a 60% interest in WFN as if the sale was consummated at the beginning of the year. These increases were also due to increases in gross income, which more than offset the general, administrative and store operating expense rate increase.

Interest Expense

	FOURTH QUARTER		YEAR		
	1997	1996	1997	1996	1995
Average Daily Borrowings (millions)	\$891.4	\$1,039.5	\$835.9	\$964.3	\$887.7
Average Effective Interest Rate	8.07%	7.49%	8.22%	7.82%	8.73%

Interest expense decreased by \$1.5 million in the fourth quarter of 1997 and decreased by \$6.6 million for the year. For the quarter, lower average borrowing levels reduced interest expense by \$2.8 million, offset by a \$1.3 million increase resulting from higher rates. For the year, lower average borrowing levels reduced interest expense by \$10.0 million, offset by \$3.4 million of increased expense due to higher interest rates.

Other Income

The \$5.1 million decrease in other income for 1997 compared to 1996 was primarily attributable to approximately \$10.5 million of interest income earned in the first quarter of 1996, which arose from \$1.615 billion of temporarily invested funds that were used to consummate the Company's self-tender in March 1996. Excluding this \$10.5 million in 1996, interest earnings increased \$5.4 million from higher temporary investments in 1997, \$3.5 million of which was realized in the fourth quarter.

Gains in Connection with Initial Public Offerings

As discussed in Note 1 to the Consolidated Financial Statements, the Company recognized a pretax gain of \$8.6 million during the first quarter of 1997, in connection with the IPO of Brylane, a 26% owned (post-IPO) catalogue retailer. In 1996, the Company recognized a \$118.2 million gain in connection with the IPO of a 15.8% interest (8.05 million shares) of A&F. In 1995, the Company recognized a \$649.5 million gain in connection with the IPO

of 16.9% (42.7 million shares) of the stock of IBI. The gains recorded by the Company in 1996 and 1995 were not subject to tax.

Other Data

There were a number of significant events in fiscal years 1997 and 1996 that impacted the comparability of the Company's net income per diluted share data. Although the following information is not intended to be presented in accordance with SEC guidelines for pro forma financial information, it is provided to assist in investors' understanding of the Company's results of operations.

- In 1997 and 1996, the Company recognized \$213.2 million and \$12 million in special and nonrecurring charges along with the \$13 million Henri Bendel inventory liquidation charge in 1997 as more fully described in Note 2 to the Consolidated Financial Statements. The impact of these charges also reduced earnings attributable to minority interest by \$6.8 million and \$1.0 million in 1997 and 1996.
- The Company recognized pretax gains in connection with IPOs of \$8.6 million and \$118.2 million in 1997 and 1996 (see Note 1 to the Consolidated Financial Statements).
- The Company repurchased 85 million shares via a self-tender and, as a result of investing funds used to facilitate the self-tender, recognized approximately \$10.5 million of interest income in 1996 up to the effective date.

Adjusted for the income tax effect (an \$87 million expense in 1997 and a \$1.0 million expense in 1996), earnings per diluted share would have increased \$.45 per share in 1997 to \$1.24 and would have decreased \$.38 per share to \$1.16 in 1996.

Acquisition

Effective July 2, 1995, the Company acquired all of the outstanding common stock of Galyan's for \$18 million in cash and stock. The Company's financial statements include the results of operations of Galyan's since the acquisition date.

Financial Condition

The Company's balance sheet at January 31, 1998, provides continuing evidence of financial strength and flexibility. The Company's long-term debt-to-equity ratio declined to 32% at the end of 1997 from 34% in 1996, and working capital increased 47% over 1996 to \$938 million. A more detailed discussion of liquidity, capital resources and capital requirements follows.

Liquidity and Capital Resources

Cash provided by operating activities, commercial paper backed by funds available under committed long-term credit agreements, and the Company's capital structure continue to provide the resources to support current operations, projected growth, seasonal requirements and capital expenditures.

A summary of the Company's working capital position and capitalization follows (thousands):

	1997	1996	Adjusted 1995	1995
Cash Provided by Operating Activities	\$589,981	\$712,069	\$340,732	\$340,732
Working Capital	\$937,739	\$638,204	\$403,960	\$2,018,960
Capitalization:				
Long-Term Debt	\$650,000	\$650,000	\$650,000	\$650,000
Shareholders' Equity	2,044,957	1,922,582	1,586,041	3,201,041
Total Capitalization	\$2,694,957	\$2,572,582	\$2,236,041	\$3,851,041
Additional Amounts Available Under Long-Term Credit Agreements	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000

Adjusted 1995 reflects the impact of the \$1.615 billion repurchase of 85 million shares of common stock.

Net cash provided by operating activities totaled \$590.0 million, \$712.1 million and \$340.7 million for 1997, 1996 and 1995 and continued to serve as the Company's primary source of liquidity.

The Company considers the following to be several measures of liquidity and capital resources:

	1997	1996	Adjusted 1995	1995
Debt-to-Equity Ratio (Long-Term Debt Divided by Shareholders' Equity)	32%	34%	41%	20%
Debt-to-Capitalization Ratio (Long-Term Debt Divided by Total Capitalization)	24%	25%	29%	17%
Interest Coverage Ratio (Income, Excluding Gain in Connection with Initial Public Offerings, Before Interest Expense, Depreciation, Amortization and Income Taxes Divided by Interest Expense)	11x	12x	12x	12x
Cash Flow to Capital Investment (Net Cash Provided by Operating Activities Divided by Capital Expenditures)	146%	174%	91%	91%

Adjusted 1995 reflects the impact of the \$1.615 billion repurchase of 85 million shares of common stock.

Net cash provided from operating activities in 1997 decreased \$122.1 million from the prior year principally due to an increase in income tax payments, that was partially offset by slightly higher income from operations adjusted for special and nonrecurring items and gains from initial public offerings.

Investing activities included capital expenditures of \$405 million, about half of which was for new and remodeled stores. Investing activities also included \$235 million in net proceeds from the sales of the Newport Tower, an office building in Jersey City, New Jersey, and the Company's interest in The Mall at Tuttle Crossing in Columbus, Ohio, and \$108.3 million of net proceeds from the third quarter sale of slightly less than one-half of the Company's investment in Brylane. In 1996, \$41.3 million was invested in the Alliance Data Systems (formerly WFN) credit card venture. 1995 reflects the acquisition of Galyan's, the proceeds from the securitization of WFN's credit card receivables of \$1.2 billion (see Note 3 to the Consolidated Financial Statements) and the transfer of \$351.6 million to a restricted cash account (see Note 6 to the Consolidated Financial Statements).

Cash used for financing activities for 1997 reflects an increase in the quarterly dividend to \$.12 per share from \$.10 per share in 1996. Financing activities in 1996 included proceeds from and repayment of \$150 million in short-term debt borrowed by A&F and net proceeds of \$118.2 million from A&F's initial public offering. Financing activities also included \$1.615 billion used to repurchase 85 million shares of the Company's common stock via the self-tender consummated in March 1996. Cash dividends paid in 1996 and 1995 were \$.40 per share.

At January 31, 1998, the Company had available \$1 billion under its long-term credit agreement. The Company also has the ability to offer up to \$250 million of additional debt securities under its shelf registration statement.

Stores and Selling Square Feet

A summary of actual stores and selling square feet by business for 1997 and 1996, and the 1998 goals by business (including the impact of the estimated 280 stores that will be closed/downsized during the year) follows:

	End of Year			Change From	
	Goal 1998	1997	1996	1998-97	1997-96
EXPRESS					
Stores	712	753	753	(41)	—
Selling Square Ft.	4,481,000	4,739,000	4,726,000	(258,000)	13,000
LERNER NEW YORK					
Stores	668	746	784	(78)	(38)
Selling Square Ft.	5,041,000	5,698,000	5,984,000	(657,000)	(286,000)
LANE BRYANT					
Stores	760	773	832	(13)	(59)
Selling Square Ft.	3,666,000	3,735,000	3,980,000	(69,000)	(245,000)
THE LIMITED					
Stores	570	629	663	(59)	(34)
Selling Square Ft.	3,398,000	3,790,000	3,977,000	(392,000)	(187,000)
HENRI BENDEL					
Stores	1	6	6	(5)	—
Selling Square Ft.	35,000	113,000	113,000	(78,000)	—
STRUCTURE					
Stores	545	544	542	1	2
Selling Square Ft.	2,161,000	2,143,000	2,117,000	18,000	26,000
LIMITED TOO					
Stores	317	312	308	5	4
Selling Square Ft.	1,002,000	979,000	967,000	23,000	12,000
GALYAN'S TRADING CO.					
Stores	15	11	9	4	2
Selling Square Ft.	1,026,000	641,000	488,000	385,000	153,000
VICTORIA'S SECRET STORES					
Stores	874	789	736	85	53
Selling Square Ft.	3,795,000	3,555,000	3,326,000	240,000	229,000
BATH & BODY WORKS					
Stores	1,101	921	750	180	171
Selling Square Ft.	2,183,000	1,773,000	1,354,000	410,000	419,000
CACIQUE					
Stores	—	—	119	—	(119)
Selling Square Ft.	—	—	365,000	—	(365,000)
PENHALIGON'S					
Stores	—	—	4	—	(4)
Selling Square Ft.	—	—	2,000	—	(2,000)
ABERCROMBIE & FITCH					
Stores	186	156	127	30	29
Selling Square Ft.	1,453,000	1,234,000	1,006,000	219,000	228,000
ABERCROMBIE (KIDS)					
Stores	13	—	—	13	—
Selling Square Ft.	42,000	—	—	42,000	—
TOTAL RETAIL BUSINESSES					
Stores	5,762	5,640	5,633	122	7
Selling Square Ft.	28,283,000	28,400,000	28,405,000	(117,000)	(5,000)

Capital Expenditures

Capital expenditures amounted to \$404.6 million, \$409.3 million and \$374.4 million for 1997, 1996 and 1995, of which \$194.4 million, \$235.7 million and \$274.5 million were for new stores and remodeling and expanding existing stores. In 1997 and 1996 the Company expended \$55.3 million and \$53.1 million on land acquisition and development costs. Also, in 1997 and 1996 the Company expended \$30.2 million and \$42.1 million in connection with the Bath & Body Works distribution center.

The Company anticipates spending \$480 to \$500 million for capital expenditures in 1998, of which \$270 to \$295 million will be for new stores, the remodeling of existing stores and related improvements for the retail businesses, \$50 to \$60 million will be for information technology related to Year 2000 expenditures and \$30 to \$40 million will be for land acquisition and development costs, principally the Easton development project in Columbus, Ohio. The Company expects that substantially all 1998 capital expenditures will be funded by net cash provided by operating activities.

The Company intends to reduce selling square footage by approximately 117,000 selling square feet in 1998, which represents a .4% decrease from year-end 1997. It is anticipated that the decrease will result from the closing of 250 stores offset by the addition of approximately 370 stores (over half of which are Bath & Body Works stores averaging 2,300 square feet) and the remodeling of approximately 125 stores.

Information Systems and "Year 2000" Compliance

The Company recently completed a comprehensive review of its information systems and is involved in an enterprise-wide program to update computer systems and applications in preparation for the year 2000. The Company will incur internal staff costs as well as outside consulting and other expenditures related to this initiative. Total expenditures related to remediation, testing, conversion, replacement and upgrading system applications are expected to range from \$85 to \$100 million from 1997 through 2000. Of the total, approximately \$50 to \$60 million will be capital expenditures related to acquisition and implementation of new package systems. The balance, approximately \$35 to \$40 million, will be expenses associated with remediation and testing of existing systems. Total incremental expenses, including depreciation and amortization of new package systems, remediation to bring current systems into compliance and writing off legacy systems, are not expected to have a material impact on the Company's financial condition during any year during the conversion process from 1997 through 2000. However, incremental expenses could total approximately \$30 to \$35 million in 1998, of which the majority will impact the first three fiscal quarters of 1998, at a rate of \$9 to \$10 million per quarter.

The Company is attempting to contact vendors and others on whom it relies to assure that their systems will be converted in a timely fashion. However, there can be no assurance that the systems of other companies on which the Company's systems rely will also be converted in a timely fashion, or that any such failure to convert by another company would not have an adverse effect on the Com-

pany's systems. Furthermore, no assurance can be given that any or all of the Company's systems are or will be Year 2000 compliant, or that the ultimate costs required to address the Year 2000 issue or the impact of any failure to achieve substantial Year 2000 compliance will not have a material adverse effect on the Company's financial condition.

Impact of Inflation

The Company's results of operations and financial condition are presented based upon historical cost. While it is difficult to accurately measure the impact of inflation due to the imprecise nature of the estimates required, the Company believes that the effects of inflation, if any, on the results of operations and financial condition have been minor.

Adoption of New Accounting Standards

During the fourth quarter of 1997, the Company adopted SFAS No. 128, "Earnings Per Share," which requires the Company to disclose basic and diluted earnings per share for all periods presented.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." While the standard has no impact in determining earnings and earnings per share, the Company will adopt the disclosure standards in 1998.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

The Company cautions that any forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) contained in this Report, the Company's Form 10-K or made by management of the Company involve risks and uncertainties, and are subject to change based on various important factors. The following factors, among others, in some cases have affected and in the future could affect the Company's financial performance and actual results and could cause actual results for 1998 and beyond to differ materially from those expressed or implied in any such forward-looking statements: changes in consumer spending patterns, consumer preferences and overall economic conditions, the impact of competition and pricing, changes in weather patterns, political stability, currency and exchange risks and changes in existing or potential duties, tariffs or quotas, postal rate increases and charges, paper and printing costs, availability of suitable store locations at appropriate terms, ability to develop new merchandise and ability to hire and train associates.