

Foot Locker Inc.

FL

Analyst: Richard Acheson
Sector: Consumer
Discretionary

BUY

Price Target: \$81.41

Key Statistics as of 3/19/16

Market Price:	\$65.22
Industry:	Specialty Retail
Market Cap:	\$8.9B
52-Week Range:	\$57.23 - \$77.25
Beta:	.55

Thesis Points:

- The recent surge in health and fitness creates a greater market and increases demand for Foot Locker's products.
- The Summer Olympics are going to create additional revenue and value for Foot Locker.

Company Description:

Foot Locker Inc. is one of the biggest retailers in athletic apparel and footwear. The company is currently selling in the United States, Canada, Australia, New Zealand, and Europe with a total of 3,423 stores. Not only do they operate inside brick and mortar stores, but they have an online presence as well generating \$865 million in revenue in 2014. The company generates revenue based on new trends and fashion statements within the athletic industry. They also have many different stores such as Lady Foot Locker, Kids Foot Locker, and Champs Sports catering to different demographics.



Thesis

In recent years, there has been a health and fitness boom within the United States. The number of gym memberships have been increase steadily over time. With this increase, it creates a greater market for Foot Locker to supply for. Not only that, but current fitness members typically purchase new shoes for their athletic activities every year or so. This gives Footlocker a sustainable market going forward.

The Summer Olympics is also another opportunity for Foot Locker to grow and create value within the very near future. The Summer Olympics creates awareness of fitness to consumers and also gives Foot Locker additional merchandise. In 2012 when the last Summer Olympics occurred, Footlocker experienced their greatest increase in revenue from the previous year at 11.4%, their greatest in recent history.

Porter's Five Forces

Bargaining power of suppliers: **MEDIUM – 62.5**

Foot Locker is dependent on its suppliers like Nike and Under Armour to come out with new shoes that will keep up with new trends that appeal to the younger generation. If their suppliers lost this ability, Foot Locker's performance might suffer.

Bargaining power of customers: **MEDIUM – 42.86**

Consumers have very little bargaining power when it comes to purchasing a certain NBA players shoe or accessory. Although there are many retailers that sell the same product, prices remain constantly high across the industry.

Threat of substitutes: **MEDIUM – 58.33**

It's easy for customers to wear a shoe that is not sold at Footlocker. People can easy wear sandals, boots, or anything else but if consumers want the quality of a shoe that is sold at Foot Locker or any other sporting goods store, they must go to one of those stores. Foot Locker places itself as a retailer of a high quality

product so if a consumer wants that quality, there are not a lot of replacements.

Existing rivalry: **MEDIUM – 41.67**

Existing rivals to Foot Locker include other retailers like Dicks Sporting Goods or Finish Line. These companies carry almost the same quality and inventory of Footlocker but there are not many others. The industry and demand for these products are relatively large so there is plenty of growth to go around.

Threat of new competition: **MEDIUM – 54.17**

To directly compete with Foot Locker, a company would need a larger amount of capital in order to obtain the high quality products that Foot Locker offers. This industry also requires a good distribution network. Foot Locker thrives on the high traffic though their stores being located mainly within shopping malls. For a company to be considered a threat, they would have to expose themselves to the same amount of traffic that Foot Locker does.

Financials

Foot Locker is in a great position financially, racking up consistent revenue growth in recent year as well as increasing consistent growth in gross, EBITDA, and net margins.

In Millions of USD	FY 2013	FY 2014	FY 2015	FY 2016
12 Months Ending	02/02/2013	02/01/2014	02/01/2015	01/30/2016
Market Capitalization	5,186.4	5,613.5	7,496.8	9,273.4
- Cash & Equivalents	928.0	867.0	967.0	1,021.0
+ Preferred & Other	0.0	0.0	0.0	0.0
+ Total Debt	133.0	139.0	134.0	130.0
Enterprise Value	4,391.4	4,885.5	6,663.8	8,382.4
Revenue, Adj	6,182.0	6,505.0	7,151.0	7,412.0
Growth %, YoY	9.9	5.2	9.9	3.6
Gross Profit, Adj	2,034.0	2,133.0	2,374.0	2,505.0
Margin %	32.9	32.8	33.2	33.8
EBITDA, Adj	740.0	805.0	946.0	1,090.0
Margin %	12.0	12.4	13.2	14.7
Net Income, Adj	404.0	435.0	522.0	606.0
Margin %	6.5	6.7	7.3	8.2
EPS, Adj	2.63	2.89	3.57	4.30
Growth %, YoY	45.9	10.1	23.7	20.4
Cash from Operations	416.0	530.0	712.0	-
Capital Expenditures	-163.0	-206.0	-190.0	-
Free Cash Flow	253.0	324.0	522.0	-

Foot Locker also has been able to keep their debt level low, giving the firm flexibility and opportunity for expansion. The only negative against Foot Locker is

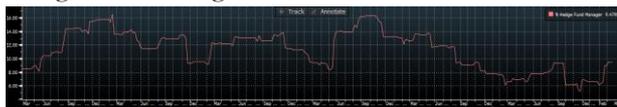
that they keep a lot of cash on hand not only recently but in past years as well. Investors would rather see this money being invested for a greater return rather than just sitting in a bank account. This does however, give Foot Locker even more of an incentive to expand. Analysts have been expecting for Foot Locker to expand their operations internationally in addition to the stores they already have, specifically in Europe.

Ownership

Foot Locker is mainly owned by investment advisors and hedge fund managers. The ownership for hedge fund managers is historically low, having its highest percentage at 16 in 2013 and have been on a decline since. Although it has seen a recent increase of 2% within the past month, meaning hedge fund managers must be expecting an increase in price in the near future.

54) Ownership Type	03/13/16	Curr	Change
41) Investment Advisor	78.96	78.75	-0.21
42) Hedge Fund Manager	9.43	9.48	+0.05
43) Bank	4.86	4.88	+0.02
44) Pension Fund	2.54	2.56	+0.02
45) Government	1.52	1.63	+0.11
46) Individual	1.23	1.24	+0.01
47) Insurance Company	1.10	1.10	0.00
48) Other	0.14	0.14	0.00
49) Endowment	0.07	0.07	0.00

Hedge fund manager trend as follows:



Risk Associated

As with any other company, there is a certain degree of risk with investing in Foot Locker. The most concerning risks are:

Changes in fashion trends can negatively effect on business: A lot of Foot Locker's business come from young males ages 12 – 25 that will purchase footwear and apparel according to current fashion trends. Foot Locker is very reliable on their suppliers to keep up with fashion trends.

Dependence on suppliers: Foot Locker must maintain a good relationship with their suppliers in order to be successful. Nike is most important in this case. 73% of Foot Locker's inventory comes from Nike. If anything were to happen to Nike, Foot Locker would take a hit financially as well.

Valuation

The target price that was calculated in the pro forma was a target price of \$81.41 with an intrinsic value of \$75.53. According to the sensitivity analysis, Foot Locker's stock price is mainly sensitive to revenue growth and operating costs with a slight impact from capital expenditures. A conservative approach was taken when valuing Foot Locker, keeping the growth rate for the explicit period at 4%, which is 5% lower than what it has historically been. 3% was the input for the continuing period. Operating costs remained the same as historical and last reported at 86% in the valuation although Foot Locker has shown slight but consistent increases in their gross and net margins in the past. Lastly, what was also sensitive to the stock price was their beta. For Foot Locker the Beta was .78 historically and last reported was .55. For the forecast, a beta of .6 was given for the explicit period as well as a .85 for the continuing period. With these conservative inputs, the pro forma still calculated an intrinsic value that is \$10 over the current stock price, making Foot Locker undervalued.

Conclusion

Foot Locker is currently undervalued at their current stock price of \$65.22. The market is not taking into account the large amount of opportunities for growth that this company has in front of them. When Foot Locker capitalizes on this growth from their different segments and events in the near future, the market should respond with a significant increase in stock price that is close to the target price that was calculated of \$81.41.

Foot Locker, Inc. (fl)
CENTER FOR GLOBAL FINANCIAL STUDIES
BULLISH

Analysis by P.C. Principal
3/19/2016

Current Price: \$65.22
Dividend Yield: 1.4%

Intrinsic Value: \$75.53
Target Price: \$81.41

Target 1 year Return: 26.27%
Probability of Price Increase: 95.33%

Description
Foot Locker, Inc. operates as an athletic shoes and apparel retailer.

Market Data
Market Capitalization: \$8,952.21
Daily volume (mil): 2.16
Shares outstanding (mil): 137.26
Diluted shares outstanding (mil): 140.80
% shares held by institutions: 105%
% shares held by investments Managers: 88%
% shares held by hedge funds: 7%
% shares held by insiders: 1.19%
Short interest: 16.05%
Days to cover short interest: 8.50
52 week high: \$77.25
52-week low: \$57.23
Levered Beta: 0.70
Volatility: 28.11%

General Information
Sector: Consumer Discretionary
Industry: Specialty Retail
Last Guidance: November 3, 2015
Next earnings date: NM
Estimated Country Risk Premium: 7.79%
Effective Tax rate: 40%
Effective Operating Tax rate: 41%

Peers
Ralph Lauren Corporation
Dick's Sporting Goods Inc.
Under Armour, Inc.
PVH Corp.
Finish Line Inc.
DSW Inc.
V.F. Corporation
Ascena Retail Group Inc.

Past Earning Surprises

Quarter ending	Revenue	EBITDA
1/31/2015	2.12%	4.99%
5/2/2015	0.07%	3.45%
8/1/2015	1.96%	16.32%
10/31/2015	0.68%	3.51%
1/30/2016	0.04%	1.03%
Mean	0.97%	5.86%
Standard error	0.5%	2.7%

Management

Management	Position	Total compensations growth
Johnson, Richard	Chief Executive Officer, Pre	-100% per annum over 4y
Peters, Lauren	Chief Financial Officer and	-100% per annum over 4y
McHugh, Robert	Executive Vice President of	-100% per annum over 4y
Alvin, Paulette	Chief Human Resources Office	-100% per annum over 1y
Berk, Jeffrey	Senior Vice President of Rea	-100% per annum over 4y
Cipriano, Giovanna	Chief Accounting Officer and	N/M

Profitability

	fl (LTM)	fl (5 years historical average)	Industry (LTM)
ROIC	5.7%	17.23%	20.00%
NOPAT Margin	7%	21.98%	6.8%
Revenue/Invested Capital	0.80	0.78	2.96
ROE	7.1%	27.02%	24.00%
Adjusted net margin	6%	19.72%	6.4%
Revenue/Adjusted Book Value	1.11	1.37	3.74

Invested Funds

	fl (LTM)	fl (5 years historical average)	Industry (LTM)
Total Cash/Total Capital	8.9%	9.6%	15%
Estimated Operating Cash/Total Capital	3.2%	3.4%	N/A
Non-cash working Capital/Total Capital	7.7%	8.4%	17%
Invested Capital/Total Capital	94.5%	93.9%	85%

Capital Structure

	fl (LTM)	fl (5 years historical average)	Industry (LTM)
Total Debt/Common Equity (LTM)	0.56	0.66	0.23
Cost of Existing Debt	2.46%	8.37%	4.37%
Estimated Cost of new Borrowing	3.38%	2.75%	3.91%
CGFS Risk Rating	2.46%	A	AA
Unlevered Beta (LTM)	3.03%	0.78	0.92
WACC	2.46%	8.84%	9.58%

Target Price Distribution--P(price↑)=95.33%

Sensitivity Attribution Analysis

Revenue	49.4%
Operating Expenses	32.9%
Dividends	0.3%
NWC	0.9%
CAPEX	16.2%
Operating Cash	0.3%

Porter's 5 forces (scores are out of 100)

Period	Revenue growth	Valuation	ROIC/WACC
Base Year	3.6%	NOPAT margin	0.90
1/30/2017	4.8%		0.93
1/30/2018	4.8%		1.22
1/30/2019	3.8%		1.31
1/30/2020	6.3%		1.46
1/30/2021	6.4%		1.70
1/30/2022	5.9%		1.61
1/30/2023	5.3%		1.51
1/30/2024	4.7%		1.49
1/30/2025	4.1%		1.35
1/30/2026	3.6%		1.30
Continuing Period	3.0%		1.22

Period	Invested Capital	Net Claims	Price per share
Base Year	\$6,420.41	\$4,779.44	\$76.32
1/30/2017	\$7,337.39	\$3,728.57	\$82.67
1/30/2018	\$8,912.39	\$3,088.65	\$90.80
1/30/2019	\$8,861.36	\$2,203.66	\$99.74
1/30/2020	\$9,218.57	\$1,017.19	\$109.61
1/30/2021	\$10,848.15	\$91.32	\$120.41
1/30/2022	\$10,323.22	-\$1,006.66	\$131.59
1/30/2023	\$10,639.97	-\$2,519.16	\$144.51
1/30/2024	\$10,872.78	-\$3,505.05	\$156.19
1/30/2025	\$11,047.10	-\$4,887.68	\$168.14
1/30/2026	\$11,811.15	-\$6,089.52	\$180.21
Continuing Period			