

## Foot Locker Inc.

NYSE:FL

**Analyst:** Dominick Iachetta  
**Sector:** Consumer  
Discretionary

**BUY**

Price Target: \$68.99

### Key Statistics as of 11/19/2015

Market Price:	\$61.53
Industry:	Specialty Footwear & Apparel
Market Cap:	\$8.6 B
52-Week Range:	\$51.12-\$77.25
Beta:	0.79

### Thesis Points:

- Growth prospects within main segments of business
- Generating momentum towards the holiday season with “Week of Greatness”
- Record setting financial performance will continue into 2016

### Company Description:

Foot Locker Incorporated is an athletic retailer that operates stores largely in the United States, Europe and Australia. Primarily based in shopping malls, the company provides athletic footwear and apparel through its different banners which include Foot Locker, Lady Foot Locker, Kids Foot Locker and Champs Sports retail stores as well as their direct to consumer website, Footlocker.com/Eastbay.



## Thesis

---

The third quarter was an extremely tough time for the retail sector as a whole. Company's like Macy's and Nordstrom were not exempt from disappointing Q3 earnings and have caused investors to panic about the sector as a whole. Even in times of market uncertainty, FL is a very strong investment based on the following: emphasis on growth and improvement in the main pillars of their business, increased product offerings and celebrity partnerships for the holiday season and consistently strong financial performance.

## Segment Growth

---

FL has identified four main pillars within their business that they are actively seeking to expand and improve upon. FL's management team has identified their Kids segment, European segment, apparel offerings and Women's segment as key opportunities to drive growth by the end of 2016. If the company is able to implement the changes to successfully improve upon these areas of the business, FL is a stock to watch out for in the next 12 months.

Currently FL has 370 Kids locations which accounts for about 11% of the company's total stores. FL plans to boost this number to 510 stores by the year 2020 by growing the brand both domestically and internationally. Management plans to create a more fun and exciting environment for families in their physical locations as well as online. FL has emphasized their plan to rapidly expand their store feature, "Fly Zone". FL, in conjunction with Nike and Jordan, has developed Fly Zone which is inspired by today's most popular athletes and brings their stories to life through customized displays and experiences. FL views expansion into their Kids segment as a value creating investment for the firm because younger shoppers are more likely to make the transition from FL Kids to FL in the near future. FL has implemented the strategy of developing brand loyalty to its customers at a very young age which will be extremely beneficial in both the near and long term.

FL views Europe as a key target to drive growth for the company. Although the company has established strongholds in parts of the continent, there are still many countries in Europe that FL has little to no presence in.

FL has identified running, basketball and lifestyle as the three key product categories that will help them increase their brand recognition in Europe. FL also plans to develop the capability for significant digital growth in Europe by creating more targeted mobile advertising in untapped markets. FL currently has 19 international locations and plans to increase this number to over 60 stores by 2020. FL plans to use its expansion into Europe to become one of the major players in the region and thus increase brand awareness even further.

One of management's primary missions in 2015 has been to enhance FL's apparel offerings available to consumers. FL plans to increase their apparel offerings with the intention of increasing number of items per transaction therefore increasing total sales. FL has highlighted a strategy that will allow them to partner with brand name vendors, like Nike and Under Armour, in order to deliver premium product lines that are differentiated from competition and vertical retailers. These partnerships coupled with private label assortments will help FL reduce lead times and stay current on emerging trends in fashion.

FL has merely scratched the surface on offerings geared toward its female customers. FL has identified its women segment as a key growth driver for the upcoming quarters. The company plans to aggressively develop SIX:02 as its primary women's brand into 2016. Launched in 2012, SIX:02's unique design was the first to offer women a broad choice of athletic wear in an environment created solely for females. The store features specific fitting zones and areas for female customers to find the exact fitness pants, sports bras, tops and footwear for their body type, activity and style. FL plans to build the overall awareness of its SIX:02 brand by clearly defining their customer base and understanding her needs, delivering a strong service model catering towards women and establishing national, market and outreach programs. Currently, FL operates 35 SIX:02 stores and plans to dramatically increase this

number by the end of 2016.

## Holiday Season

FL is preparing for the approaching holiday season with the launch of its fourth annual Week of Greatness. The Week of Greatness features daily premium sneaker releases from some of the most popular brands in the world such as Nike, Under Armour and Jordan. Part of the main focus heading into holiday season is taking advantage of the high demand for retro footwear that currently exists in today's sneaker world. FL is poised to take advantage of this rising trend and have a very strong holiday season.

Along with their schedule of new footwear being offered, FL's marketing strategy for Week of Greatness has not only increased the awareness of the campaign but also for the entire brand itself. FL has teamed up with superstars Steph Curry and Aaron Rodgers to release new commercials for Week of Greatness. Curry and Rodgers, two professional athletes at the pinnacle of their sports, will help the company propel itself to the main stream for the upcoming holiday season. In this industry brand recognition is paramount in order to separate from competitors. The ability to promote their brand at this crucial part of the year in will bring FL to the forefront of shoppers' minds. Their new focus on increased apparel offerings, traditionally strong and ever-growing footwear selection and their increased advertising with world class athletes sets FL up for an extremely strong Christmas season.



## Financial Analysis

---

The first two quarters of 2015 have been extremely strong for FL. Since the beginning of the year, FL has generated

a company record of \$303 million in net income. In the second quarter reported same store sales growth of 9.6% and EPS of \$0.84, both beating analyst consensus estimates. The second quarter also saw the Lady's segment

increase same store sales for the sixth consecutive quarter – a feat that hasn't been accomplished in the last decade.

Many other retailers in the current environment have reported disappointing earnings for the third quarter due to above average temperatures and decreased foot traffic within stores. FL's product mix coupled with its increased exposure to European markets will offset the negative performance of the entire retail sector. Although many of FL's competitors generated revenue and EPS below expectations, most reported increased strength in the footwear segment, which bodes well for FL's Q3 earnings. Additionally, On November 18, FL announced a quarterly dividend of \$0.25 per share to be paid at the end of January 2016. This dividend payment along with the \$76 million share repurchase earlier in the second quarter are positive signs for the coming months. The company's strong performance to date in 2015 as well as its promising financial outlook for the remainder of the year leads to strong upside potential for the stock in the near future.

---

## Summary

---

I am recommending a BUY on FL based on its strong growth trajectory and overall upside potential. Third quarter earnings will be released before the market opens on November 20<sup>th</sup>. This earnings report should act as a strong catalyst for the stock to gain momentum going into the holiday season. In conclusion, FL is an undervalued company that will continue to create additional value in 2016 and beyond.

**CENTER FOR GLOBAL FINANCIAL STUDIES**

Foot Locker, Inc.		Analyst Dom Iachetta	Current Price \$58.10	Intrinsic Value \$68.52	Target Value \$68.89	Divident Yield 2%	1-y Return: 20.21%	<b>NEUTRAL</b>	
General Info		Peers	Market Cap.	Management					
Sector	Consumer Discretionary	Ralph Lauren Corporation	\$10,217.55	Professional	Title	Comp. FY2013	Comp. FY2014	Comp. FY2015	
Industry	Specialty Retail	Dick's Sporting Goods Inc.	\$4,838.67	Johnson, Richard	Chief Executive Officer, President and Director	\$3,627,889	\$9,738,709	\$0	
Last Guidance	August 21, 2015	Under Armour, Inc.	\$19,409.58	Peters, Lauren	Chief Financial Officer and Executive Vice Pres	\$2,064,751	\$3,634,835	\$0	
Next earnings date	November 20, 2015	Finish Line Inc.	\$714.36	McHugh, Robert	Executive Vice President of Operations Supp	\$2,419,738	\$4,544,023	\$0	
Market Data		PVH Corp.	\$7,155.67	Alviti, Paulette	Chief Human Resources Officer and Senior V	\$2,500,260	\$2,248,530	\$0	
Enterprise value	\$7,405.02	DSW Inc.	\$1,964.78	Beik, Jeffrey	Senior Vice President of Real Estate	\$1,664,419	\$2,041,831	\$0	
Market Capitalization	\$4,838.67	V.F. Corporation	\$26,755.15	Cipriano, Giovanna	Chief Accounting Officer and Senior Vice Pres	\$0	\$0	\$0	
Daily volume	4.80	Hanesbrands Inc.	\$12,023.02	<b>Past Earning Surprises</b>					
Shares outstanding	139.38	#REF!	#REF!	Revenue		EBITDA	Norm. EPS	Standard Error of "Surprise"	
Diluted shares outstanding	143.35	Genesee Inc.	\$1,277.98	Last Quarter	1.96%	16.32%	21.74%	5.90%	
% shares held by institutions	73.36%	<b>Current Capital Structure</b>		Last Quarter-1	0.07%	3.45%	4.88%	1.42%	
% shares held by insiders	1.17%	Total debt/ Common Equity (LTM)	0.53	Last Quarter -2	2.12%	2.50%	9.89%	2.53%	
Short interest	9.98%	Cost of Borrowing (LTM)	8.18%	Last Quarter -3	0.37%	2.06%	3.06%	1.37%	
Days to cover short interest	6.19	Estimated Cost of new Borrowing	3.65%	Last Quarter -4	4.28%	13.46%	18.52%	4.17%	
52 week high	\$77.25	Altman's Z	8.90	Standard error	0.8%	3.0%	3.5%	1.83%	
52-week low	\$51.12	Estimated Debt Rating	AA	Standard Error of Revenues prediction	0.8%	<b>Industry Outlook (Porter's Five Forces)</b>			
5y Beta	0.68	Current levered Beta	0.66	Imputed Standard Error of Op. Cost prediction	2.9%	Bargaining Power of Suppliers (75th Percentile), Bargaining Power of Customers (14th Percentile), Intensity of Existing Rivalry (33th Percentile), Threat of Substitutes (-67th Percentile), Threat of New Competition (67th Percentile), and Overall (67th Percentile).			
6-month volatility	26.84%	LTM WACC	4.77%	Imputed Standard Error of Non Op. Cost prediction	1.7%				
Proforma Assumptions									
Convergence Assumptions		General Assumptions		Items' Forecast Assumptions			Other Assumptions		
All base year ratios linearly converge towards the Peers ratios over an explicit period of 10 years		Money market rate (as of today)	0.41%	Base year (LTM)		Convergence period (Peers)	Adjustment per year	Tobin's Q	80%
		Risk-Free rate (long term estimate)	3.07%	Operating Cash./Rev.	0.00%	0.00%	0.0%	Excess cash reinvestment	Money market rate
		Annual increase (decrease) in interest rates	0.1%	NWV./Rev.	11.66%	14.30%	0.3%	Other claims on the firm's assets	\$0.00
		Marginal Tax Rate	37.5%	NPPE./Rev.	8.88%	12.11%	0.3%	<b>Capitalization</b>	
		Country Risk Premium	6.0%	Dpr./NPPE	20.65%	17.85%	-0.3%	100% of all rent expenses are capitalized and amortized 'straightline' over 10 years	
				NOPAT MARGIN	9.11%	9.00%	0.0%	100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years	
Forecast Year	Revenue Growth Forecast	Revenue (\$) Forecast	Op. Exp./Rev.	85.58%	86.42%	0.1%	0.0%	E&P expenses are not capitalized	
LTM		\$7,253.00	SBC./Rev.	0.32%	0.73%	0.0%	0.0%	SG&A expenses are not capitalized	
FY2016	1.7%	\$7,376.54	Rent Exp./Rev.	8.75%	4.95%	-0.4%	0.0%	<b>Valuation Focus</b>	
FY2017	5.4%	\$7,771.31	R&D./Rev.	0.00%	0.44%	0.0%	0.0%	DCF Valuation	
FY2018	5.7%	\$8,211.64	E&D./Rev.	0.00%	0.00%	0.0%	0.0%	Relative valuation	
FY2019	6.4%	\$8,735.30	SG&A./Rev.	27.78%	33.22%	0.5%	0.5%	Distress Valuation	
FY2020	4.2%	\$9,099.00	ROC	9%	10.52%	0.20%	0.20%	<b>Monte Carlo Simulation Assumptions</b>	
FY2021	3.6%	\$9,424.91	EV./Rev.	1.24x	1.16x	-0.01x	-0.01x	Revenue Growth deviation	
FY2022	3.3%	\$9,735.07	EV/EBITA	8.63x	7.55x	-0.11x	-0.11x	Operating expense deviation	
FY2023	3.1%	\$10,041.28	Debt./Equity	53%	398%	34.5%	34.5%	Continuing Period growth	
FY2024	3.1%	\$10,349.82	Unlevered beta	0.49	1.00	0.05	0.05	Country risk premium	
FY2025	3.0%	\$10,664.08	Dividends./REV	2%	2%	0.0%	0.0%	Intrinsic value σ(ε)	
Continuing Period	3.0%	\$10,984.00						1-year target price σ(ε)	
								\$0.10	
Valuation									
Forecast Year	ROC	WACC	Total Capital	Implied Enterprise Value	Other Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share	Monte Carlo Simulation Results	
LTM	8.3%	4.8%	\$7,827.00	\$9,351.61	\$370.86	139.38	\$68.60		
FY2016	8.8%	5.0%	\$7,876.88	\$9,185.87	\$376.22	139.38	\$68.35		
FY2017	9.0%	5.8%	\$8,374.12	\$9,509.19	\$382.93	139.38	\$70.16		
FY2018	8.9%	6.3%	\$8,902.89	\$9,891.92	\$390.16	139.38	\$72.49	The 3σ(ε)-adjusted intrinsic value is \$68.52; the 3σ(ε)-adjusted target price is \$68.89; and the analysts' median target price is \$75.86	
FY2019	8.8%	6.7%	\$9,485.04	\$10,355.35	\$398.19	139.38	\$74.56		
FY2020	8.6%	7.2%	\$9,967.35	\$10,768.69	\$277.29	139.38	\$76.84		
FY2021	8.4%	7.6%	\$10,425.79	\$11,213.68	\$177.29	139.38	\$79.16		
FY2022	8.2%	8.1%	\$10,873.56	\$11,711.74	\$182.00	139.38	\$81.36		
FY2023	8.1%	8.5%	\$11,317.21	\$12,278.67	\$99.28	139.38	\$84.22	<b>Sensitivity Analysis</b>	
FY2024	7.9%	9.0%	\$11,759.92	\$12,928.36	\$0.00	139.38	\$87.17	Revenue growth variations account for 95.9% of total variance	
FY2025	7.8%	9.4%	\$12,203.14	\$13,674.89	\$0.00	139.38	\$91.11	Risk premium's variations account for 2.5% of total variance	
Continuing Period	10.5%	9.6%	\$10,023.47					Operating expenses' variations account for 1.4% of total variance	
								Continuing period growth variations account for 0.2% of total variance	