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Siena Market Line
2nd week of April 2016

DSW Inc.

NYSE:DSW

Analyst: Florent Polito
Sector: Consumer Disc.

BUY

Price Target: $35.07

Key Statistics as of 03/17/2016

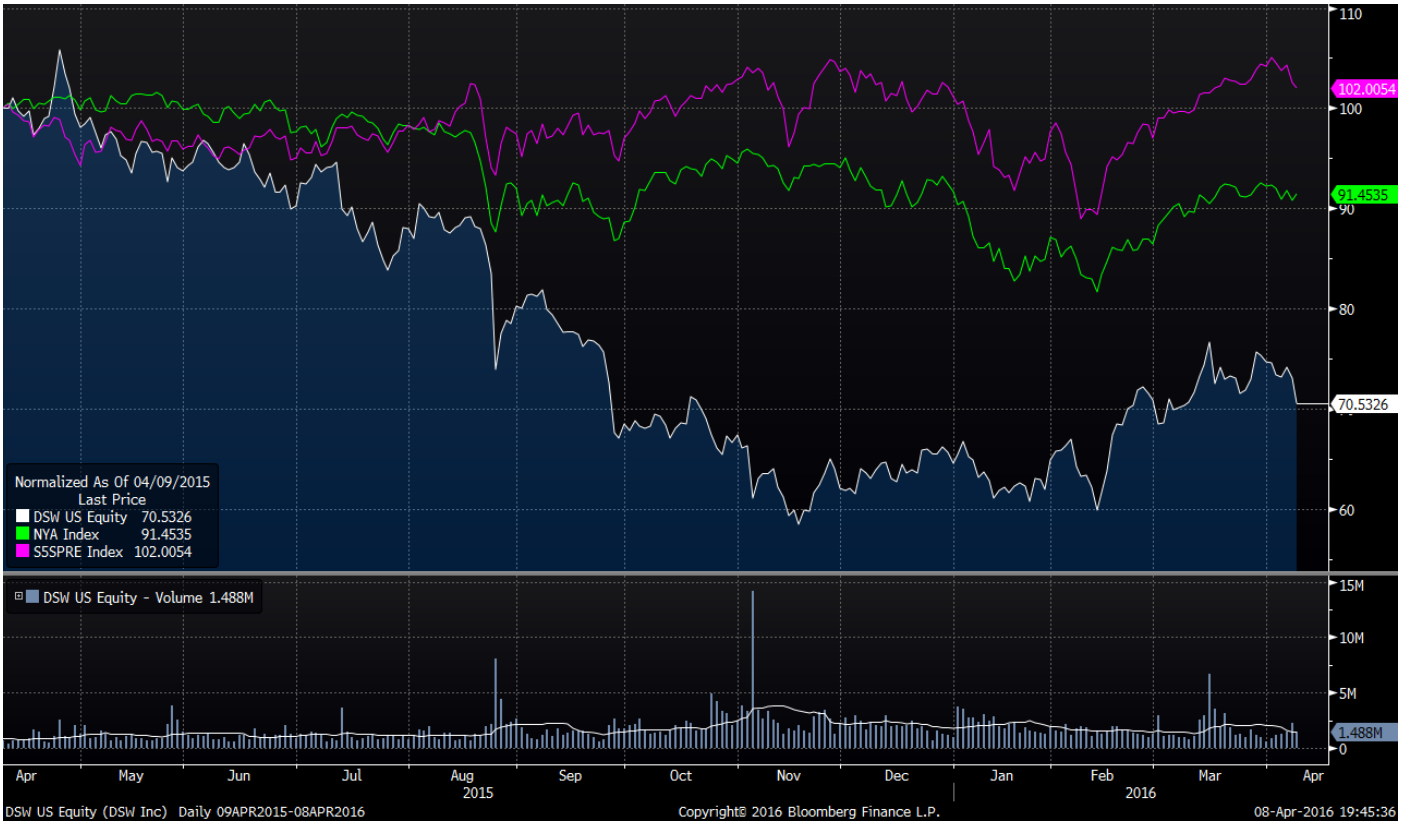
Market Price:	$26.09
Industry:	Specialty Retail
Market Cap:	$2.14B
52-Week Range:	$21.62-$39.14
Beta:	0.76

Thesis Points:

- DSW's strategy and marketing secures steady revenues
- The company is currently undervalued due to a change in management
- The company is targeting a larger base of customers which will boost revenues

Company Description:

DSW is an American specialty footwear retailer operating in the United States. The company offers a wide selection of brand name and designer dress, casual, and athletic footwear for women and men. DSW possesses and markets several private-label brands such as Audrey Brooke, Kelly & Katie, Lulu Townsend, and Poppie Jones-branded shoes and purses. The company is publicly traded since its IPO in 2005 and is headquartered in Columbus, Ohio. DSW announced its merger with Retail Ventures in February 2011.

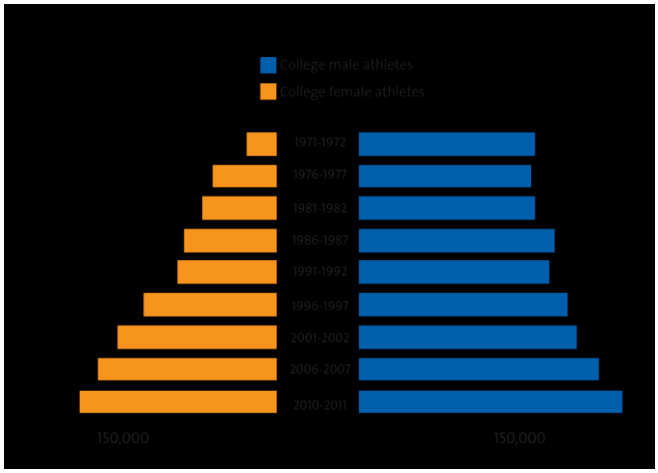


Thesis

DSW is a company that knows how to deal with demand and focuses on dollar margin, which makes it a company with predictable steady revenue, and a safe stock. Moreover it is likely that the company will benefit from lower raw materials prices this year to reduce their costs and increasing their margins. The company has had a decrease in its stock price recently very likely attributed to a big shift in management which the retirement of the previous CEO and the appointment of a new one, this appears to make DSW undervalued as the expectations about the new management should not be negative. Last but not least, DSW has a lot of developing opportunities for its near future which will logically increase its revenues and make the brand stronger.

Industry Outlook

Sports apparel and footwear sales have jumped 42% to $270 billion over the past seven years. Estimates report that the industry could add $83 billion in sales by 2020, which represents more than 30% of growth. In North America, sports participation among high-schoolers overall has jumped from 25% to more than 35% over the past 35 years, led by a near doubling among girls, from 17% to 32% over that period. College students enrolling as athletes has consequently reached a record especially among women which number has been almost multiplied by 6 within 40 years.



Recently last year, the outlook for the US apparel and footwear industry has changed to stable from positive as sales and earnings take a hit from the stronger dollar, says Moody's Investors Service. The industry is expected to grow between 4 and 6% over 2016 and will very likely benefit from a decrease in price of both cotton and oil, which will decrease their input costs, and help the industry to remain attractive and they can more easily adapt their prices. Still the industry in America may be challenged due to the appreciation of the dollar against the euro as they may struggle more to export their goods.

Porter Five Forces

Bargaining Power of Customers: Medium
Customers have a relative bargaining power on DSW; though it is at first sight easy for them to switch brands, the company has developed a reward program that includes 24 million members, which creates at minima some loyalty toward their customers. The company also have a strong brand image as it is nationwide represented and is one of the biggest in the USA.

Bargaining Power of Suppliers: Medium
Suppliers can have some bargaining power as DSW volume needs is not critical for them which means the loss of DSW as a buyer might not interfere a lot in their revenue though DSW buys high volume as it possesses in average stores with 21,000 square foot which can contain up to 21,500 pairs of shoes. On the contrary, the decrease in cotton price gives an edge for DSW which can buy raw materials or shoes at a lower price.

Threat of New Competition: Medium
DSW has relatively no worries to have about new entrants, in effect the company is nationwide implanted in the USA, and benefits from an economy

of scale that new entrants would have difficulty to reach consider the high level of inventory and assets required. Being a athletic footwear retailer means the necessity of having stores and stocks as well as usually trained employees that can help the consumer find what they are looking for. On the opposite, entering in this industry does not require special patents or technology and inputs cost are relatively low, which makes the threat medium/low overall.

Threat of Substitutes: Low
Athletic footwear do not really have any substitutes as nothing can replace those kind of clothes when one wants to practice sport, but still there is an almost infinite variety of clothes that consumers can buy, and DSW like any other brand cannot offer all this infinite range.

Existing Rivalry: Medium
There is existing rivalry among big competitors such as FootLocker but DSW has channeled several private-label brands that give the company a unique edge compared to its competitors.

Management

In January of 2016 the new CEO Roger Rawlins succeeded to the company after the retirement of Mike McDonald. The announcement made om November 3rd has led to a big decrease of the stock price from $24.51 to $21.64 overnight which represents a decrease of 11.71%. Volume exchanged this day amount 14 million compared to the usual 2.5 million, which means this news was definitely important for the company. This announcement must have been seen has a negative news, but the company has had Roger Rawlins working there for 10 years, lastly occupation the post of Executive Vice President and Chief Innovation Officer, which means that he already have experience in leading and managing and working with the current team. With the results of the first semester of 2016, it seems clear that the management if efficient and the market overreacted to the announcement and the stock price suffered from an unjustified drop,

Company Strategy

DSW is a company that constantly seek to increase revenue and develop, the company has already planned the opening of 14 new stores in the USA during Spring 2016. In its most recent earning of March 2016, the new appointed CEO Roger Rawlins has announced that after an experimentation in 22 stores, the company was going to expand in all its stores a new kids department, that the CEO believes is going to attract a lot of customers, especially the segment of adults married with children, that has been a left out segment before as the main market was mostly single adults or married couples without children. The launching of this new department will definitely boost sales though it is yet unpredictable at which point. On the other side, DSW is also focusing on strengthening its market shares through aggressive marketing and fast reactions to new trends and tendencies. In effect, as the CEO mentions as the sales of Winter 2015 were supposed to slow down compared to 2014, the company has offered reductions in order to sale more, and lower their inventories at a maximum, thus reducing operating costs, overall the company has mentioned being more interested by dollar margin rather than gross margin and operating margin, which means that while it has lowered their gross margin from 32% to 30% the company has had an increase in revenue. Last but not least the CEO announced during the company's earnings call that DSW will open 10 new stores in Canada and the company is currently looking for opportunities to develop outside North America.

Recent Acquisition

DSW has announced the acquisition of Ebuys on February 17th, driving an increase of the stock price up by 5.65% during that day. San Diego-based Ebuys sells discount shoes and accessories in North America, Europe, Australia and Asia. DSW has announced in its earnings call that due to the acquisition of Ebuys there was an expected increase of operating expenses of 10% for 2016 necessary to make Ebuys work with DSW. The acquisition of Ebuys fits well with the strategy of DSW to expand outside North America and open up to a whole new market with a lot of potential customers.

Financials

During 2015, DSW has issued $70 million in dividends, and they have repurchased 5 million shared for $112 million on November 3rd, indicating that the

company thinks its stocks are undervalued and cheap. Revenues have increased by 5% in 2015 and an expected 9% growth increase is expected in 2017 once Ebuys will be fully operating with DSW, a 400 basis points over the 2015 revenues and over the industry growth. DSW has EBITDA margin and Net Income margin steady compared to 2014 with respectively 12.7% and 6.3% which represents a 20 and 10 basis points loss. Forecasts for 2016 show a decrease of those margins by 170 and 110 basis points due to the increase in operating costs after the acquisition of Ebuys, this will be offset by 2017 therefore there is nothing to worry about.
When considering the EV/EBITDA and EV/Sales ratios they are both under the industry average, those ratios are respectively at 6.50 and 0.66 where the industry average is 9.68 and 1.08, implicating that the company is presently undervalues.

Valuation

Running a proforma and a Monte Carlo simulation, the stock price of DSW has a 96.33% probability to increase during 2016 with a 1 year target return of 30.27% at a target price of $35.07 and an intrinsic value at $31.56. I added a 2% premium when discounting the cash flows which is quite huge and represents a little uncertainty and a conservative value of the shift in management and the development of the kid department alongside the acquisition. Overall, even with a conservative 2% premium the company is expected to create value, and increase its revenues and its presence in the USA at minima in 2016.

Conclusion

I recommend to buy this stock who has a lot of opportunities of growth in its near future both in United States and outside of it. Its steady actual revenue combined to the opening of a new kid department will drive the stock price up, which can even come back to its early 2015 price of $40 dollars, we can expect furthermore an increase in stock price once the professionalism of its management and the success of its strategy would have been shown in the future quarter numbers. The stock is currently undervalue and is cheap enough to be considered as a very valuable investment over at least the next 2 years.

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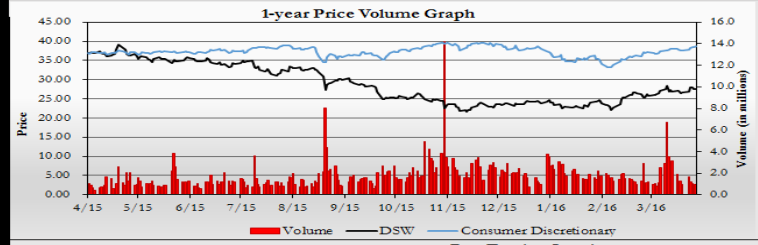
2nd week of April 2016

DSW Inc. (DSW) — CENTER FOR GLOBAL FINANCIAL STUDIES — BULLISH

Analysis by Florent POLITO	Current Price:	$27.58	Intrinsic Value	$31.56	Target 1 year Return: 30.27%
4/8/2016	Divident Yield:	3.1%	Target Price	$35.07	Probability of Price Increase: 96.33%

1-year Price Volume Graph



Description

DSW Inc., together with its subsidiaries, operates as a branded footwear and accessories retailer in the United States.

General Information

Sector	Consumer Discretionary
Industry	Specialty Retail
Last Guidance	November 3, 2015
Next earnings date	May 24, 2016
Estimated Country Risk Premium	8.00%
Effective Tax rate	40%
Effective Operating Tax rate	38%

Market Data

Market Capitalization	$2,216.70
Daily volume (mil)	0.65
Shares outstanding (mil)	81.92
Diluted shares outstanding (mil)	88.50
% shares held by institutions	55%
% shares held by investments Managers	84%
% shares held by hedge funds	10%
% shares held by insiders	17.06%
Short interest	8.44%
Days to cover short interest	3.91
52 week high	$39.58
52-week low	$21.23
Levered Beta	0.80
Volatility	0.00%

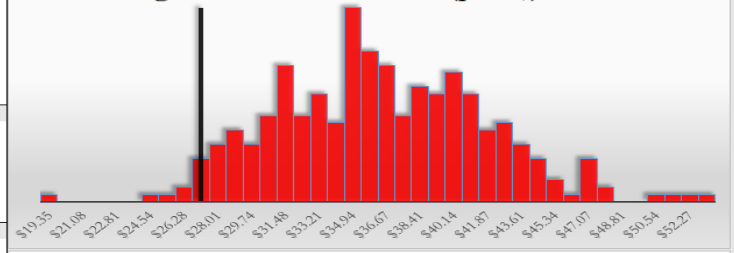
Past Earning Surprises

Quarter ending	Revenue	EBITDA
1/31/2015	4.49%	20.79%
5/2/2015	-0.13%	9.70%
8/1/2015	-1.50%	1.76%
10/31/2015	0.09%	-0.38%
1/30/2016	4.73%	38.97%
Mean	1.54%	14.17%
Standard error	1.3%	7.2%

Peers

Caleres, Inc.
Finish Line Inc.
Genesco Inc.
Wolverine World Wide Inc.
Skechers U.S.A., Inc.
Foot Locker, Inc.
Columbia Sportswear Company
Steven Madden, Ltd.

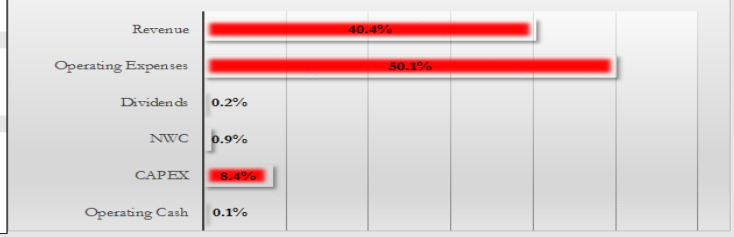
Target Price Distribution--P(price↑)=96.33%



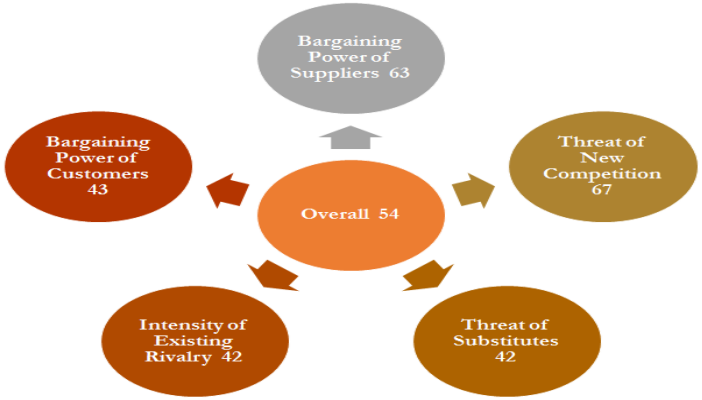
Management	Position	Total compensations growth	Total return to shareholders
Schottenstein, Jay	Executive Chairman	-100% per annum over 4y	N/M
Meixelsperger, Mary	Chief Financial Officer and	N/M	0% per annum over 0y
McDermott, Carrie	Chief Operating Officer and	-100% per annum over 2y	5.73% per annum over 2y
Ferrée, Deborah	Vice Chairman and Chief Merc	-100% per annum over 4y	N/M
Rawlins, Roger	Chief Executive Officer and	N/M	N/M
Jordan, William	Chief Administrative Officer	N/M	N/M

Profitability	DSW (LTM)	DSW (5 years historical average)	Industry (LTM)
ROIC	11.8%	10.96%	20.05%
NOPAT Margin	9%	9.25%	6.8%
Revenue/Invested Capital	1.25	1.18	2.96
ROE	13.3%	15.36%	24.24%
Adjusted net margin	8%	8.30%	6.4%
Revenue/Adjusted Book Value	1.59	1.85	3.76
Invested Funds	**DSW (LTM)**	**DSW (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	10.6%	13.1%	17%
Estimated Operating Cash/Total Capital	1.3%	3.1%	N/A
Non-cash working Capital/Total Capital	8.7%	9.1%	16%
Invested Capital/Total Capital	87.5%	84.1%	84%
Capital Structure	**DSW (LTM)**	**DSW (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.68	0.43	0.24
Cost of Existing Debt	3.38%	3.36%	4.75%
Estimated Cost of new Borrowing	3.37%	3.21%	3.93%
CGFS Risk Rating	3.38%	BBB	AA
Unlevered Beta (LTM)	0.00%	0.58	0.92
WACC	3.38%	6.35%	9.76%

Sensitivity Attribution Analysis



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



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	5.0%	9.5%	1.65
1/30/2017	9.0%	8.4%	1.64
1/30/2018	5.3%	8.6%	1.57
1/30/2019	5.0%	8.4%	1.45
1/30/2020	4.8%	8.5%	1.47
1/30/2021	4.5%	8.5%	1.46
1/30/2022	4.3%	8.5%	1.45
1/30/2023	4.0%	8.6%	1.44
1/30/2024	3.8%	8.6%	1.43
1/30/2025	3.5%	8.6%	1.42
1/30/2026	3.3%	8.7%	1.40
Continuing Period	3.0%	8.7%	1.39

Period	Invested Capital	Net Claims	Price per share
Base Year	$1,542.38	$1,147.79	$32.45
1/30/2017	$1,685.93	$1,237.58	$34.79
1/30/2018	$1,861.67	$1,274.03	$37.41
1/30/2019	$1,956.98	$1,167.17	$40.18
1/30/2020	$2,097.44	$1,100.78	$43.03
1/30/2021	$2,141.81	$1,027.04	$45.98
1/30/2022	$2,403.34	$900.33	$49.54
1/30/2023	$2,634.64	$809.62	$52.71
1/30/2024	$2,719.23	$709.57	$55.99
1/30/2025	$2,854.00	$599.66	$59.39
1/30/2026	$2,988.79	$479.40	$62.92
Continuing Period			