Dick's sporting goods, equity valuation and analysis

Sport & Tourism

 Executive Summary After analyzing Dick’s Sporting Goods and taking into account both positive and negative aspects associated with the stock, I am giving the stock a Moderate Buy Recommendation, with a target price of $46. 50. The recommendation took into account DKS’s recent earnings report, improving financialhealth, growth estimates, and industry outlook. In this report I will evaluate the current overall economic conditions and how they affect the Sporting Goods Stores industry and the Retail sector in general.

The report then focuses on Dick’s Sporting Goods’ key measure of financial health, profitability, and growth compared to historical levels and competitors. A P/E Multiple analysis and a Free Cash Flow to Equity valuation approach was then used to derive an intrinsic value of the stock. Company Overview Dick’s Sporting Goods is the largest Sporting Goods Store in the United States, selling sports equipment, exercise and fitness equipment, apparel and footwear along with outdoor sports equipment and accessories.

Dick’s was founded in 1948 and operates 455 stores in 42 states primarily in the eastern part of the United States. Dick’s Sporting Goods controls 13. 4% of the market share within the industry and has the largest market cap at $4. 75 billion. When the most recent fiscal year ended in January of 2011 (FY 2010), Dick’s Sporting Goods generated over $4. 8 billion in sales and had Net Income of just over $182 million. Currently Dick’s Sporting Goods has 120. 72 million shares outstanding. Economic Analysis GDP Growth Recently GDP grew at an annualized rate of 1. % and 2% in the second and third quarters of 2011 respectively. Consumer Spending is one of the key drivers and is a large portion of the US economy and with consumer confidence still below healthy levels. Combined with low consumer spending current monetary and fiscal policy have prevented GDP from getting above the aforementioned growth levels for an extended amount of time. Also contributing to low GDP is the traditionally higher unemployment as of late, lack of confidence in the US government, and low home values as a result of the housing crisis.

The low growth in GDP will more than likely continue in the near future as the economy will work out of the recent recession and will therefore keep interest and inflation rates. Once the economy starts to strengthen and expand however, GDP growth rates will increase from their current bleak levels. Inflation Inflation expectations have remained low recently, showing trust in the Red to monitor/control inflation rates when the economy begins to start expanding.

With Ben Bernacke and the Fed’s commitment to keep interest rates at their historically low levels, it seems that monetary policy is following a trend of attempting to prevent any policy from causing further struggle to the U. S. economy. In the short term there seems to be no immediate threat/fear of inflation rising in the US. According to an article from Reuters, the Fed wants to keep inflation around its 2% target in order confirm the Federal Reserve’s ability to keep control over inflation levels. Interest Rates

Interest rates set by the US Federal Reserve within its over-arching monetary policy are very important in terms of the world economy. Recently the Fed pledged to keep the federal funds rate close to zero through mid year 2013. Operation Twist, a plan to buy long-term U. S. debt and sell short-term debt, which will result in a flattening of the yield curve and a drop in long-term debt yields, is a part of the expected future according to the Fed. This means that the historical lows in interest rates that we are seeing will continue in the short run.

In the long run however, there looks to be a divergence from that short-run trend. Consumers and businesses in the long-run will get away from the de-leveraging process that we are seeing in the recent past and currently and begin to build up cash that will circulate more unreservedly. This will cause the Fed to set interest rates at higher levels in order to combat against the rise in inflation in the post-deleveraging period. Housing Post-housing/financial crisis of 2007-2009, the housing market seems to be showing signs of improvement after great downturn.

With the downturn in housing prices, many homeowners did not have enough equity to avoid taking a loss on the sale of their homes so they are sitting with home loans based off of higher-than-current mortgages. However, in November the National Association of Home Builders’ sentiment index jumped to 20, which is the highest reading in over a year. Demand for mortgages has also seemed to pick up a bit according to the Fed’s 4th quarter loan survey. Construction remains at historically low levels but has increased as of late, and the number of foreclosures has increased this quarter also.

These trends do seem to be geared to a more short-term thought process and many analysts believe that in the long run, the housing market will improve and strengthen along with the strengthening of the US economy. Consumer Spending In October personal income increased $48. 1 billion and disposable personal income increased $30. 2 billion according to the Bureau of Economic Analysis. In addition, personal consumption expenditures increased $8. 2 billion. With consumer spending representing about 70% of total GDP increases in the different income categories translates into more consumer spending.

Analysts believe that with continued increasing we can start to return to pre-recession levels of spending. This increase is a positive sign for retailers because there is more disposable income to purchase their products than recently as we continue to move away from recessionary levels. From the chart below you can see the upward trend from the 2008 lows in personal consumption spending. The chart on the next page does a good job portraying the recent trends in consumer spending. Sovereign Debt Foreign currencies have been seen weakening relative to the US dollar due to many debt issues in countries abroad.

This has caused investors to flock towards the safest reserve currency, which is the US dollar. Fear in Europe stems from economies that are much too large to be bailed out or allowed to completely default on their debt and the means for a solution have not come about as of yet. Greece, Italy, and Spain are among those countries that are seeing investor fear and are also causing investors to be cautious to the other European economies, even ones that have proved to be more reliable (Germany and France). There have been austerity measures that are aimed at reducing the debt levels of the countries in fear of defaulting however oliticians in the near future must discuss the outlook of the European Union and whether or not there is a need for countries to break apart. These threats significantly reduce the expected growth in forecasted GDP and spending, which could be harmful to worldwide markets that depend on Europe. Unemployment The unemployment rate and the number of unemployed persons have remained stagnant through October ranging around 9%-9. 2% and 13. 9 million respectively. Within retail trade, employment increased in general merchandise stores and the industry has added 156, 000 jobs over the past 12 months.

The unemployment rate is forecasted to decline as the economy starts to strengthen and pull its way out of recessionary levels. This obviously affects consumer spending and consumer confidence in general. Higher unemployment rates tend to mean less disposable income, which would affect the pricing point of retailers and would hurt big ticket items such as different luxury goods. With dropping unemployment rates predicted for the future, consumer confidence will ultimately increase and consumer spending, therefore benefitting the retail sector. Value of the US Dollar

As mentioned before with the fear of default and crisis abroad foreign currencies have weakened in relation to the dollar. Also this chaos in Europe helps support against the loose monetary policy of late, limited growth see in GDP, and large trade deficits, which would otherwise weaken the dollars position. Investors favor the safety that the US dollar provides. This strengthening in comparison to other currencies also gives sentiment to the fact that investors are becoming more and more confident in the US market again and thus moving more and more capital back into it.

In the near futureI believethat the dollar will remain strong relative to other foreign currencies and that investor confidence from abroad will continue as a direct relation to a strong future currency. Impact on Industry Many of the indicators listed in the Economic Analysis greatly affect the Retail Sector and Sporting Goods Stores Industry as a whole. The most obvious one is the gradual rise in consumer spending and therefore GDP. Both of these are positive signs for the retail sector, who’s profits are directly linked to variations in consumer spending.

Consumer spending will also increase when consumer deleveraging process begins to slow down in the next few years. Due to low consumer confidence as a result of the financial crisis people were paying down more debt in order to be more financially healthy (deleveraging.) As confidence increases consumers will use more disposable income towards consumption and less towards paying down debt. The high unemployment rates that we are currently seeing have negative effects on disposable income and therefore negatively affect the retail sector.

However, with the forecast of adding jobs and a declining unemployment rate, the result will be increases in disposable income and therefore increases in consumer spending. The strong dollar in relation to foreign currencies makes US goods more expensive, however this does not have an adverse effect on Dick’s Sporting Goods because it generates the vast majority of its sales domestically. Industry Analysis Dick’s Sporting Goods operates in the Sporting Goods Stores Industry within the Retail Sector.

Companies in this industry retail new sporting goods including sports equipment and apparel, exercise and fitness equipment, footwear and other sporting goods and accessories. Dick’s Sporting Goods also owns 81 Golf Galaxy stores in 30 states. DKS operates in off-mall locations and feature an interactive store-within-a-storeenvironment. Revenue growth for the past five years in the industry has been volatile due to drivers such as high volatility in disposable income. Average annual revenue growth over the past five years was just 0. 3% and the forward five years are forecasted for average annual revenue growth of 2. % Porter Five Forces Barriers to Entry The most dominant barrier to potential entrants into the industry has to do with the large start-up costs associated with firms. The initial cost of establishing a retail outlet or acquiring a retail outlet with sufficient inventory to supply customers is a great inhibitor to new entrants. High marketing and advertising costs are also important cost barriers to be dealt with in order to become competitive in the industry. This expenditure increased in the five years to 2011, which was a directly from rises in competition.

This has caused massive investment in brand promotion and promotional campaigns in attempts to increase store traffic and differentiate. This is another capital barrier to entry for possible entrants. In addition, the present and well-established channels of distribution between suppliers and the major players of the industry can be a major deterrence. In order to achieve success new entrants would have to need to somehow establish strong relationships with the upstream manufacturers and wholesalers in order to obtain high quality, low-priced stock. Competition

Despite their low market shares individually the concentration in the Sporting Goods Stores industry is increasing due to increases in M&A as of late. This trend along with the growth in the number of outlets operated by the larger players of the industry create high levels of difficulty for the smaller and specialty firms within the industry. These smaller firms have been forced to reduce product margins in order to remain competitive. In addition, IBISWorld estimates that through 2016 the number of enterprises within the industry will grow at an average rate of 0. 9%, further intensifying competition.

There has been recent competition from department stores and other mass merchandisers and IBISWorld predicts that this will be the single biggest threat to the industry in the years to 2016. Because of their great size and buying power, these competitors are able to offer merchandise at considerably lower prices and in bulk quantities. From there department stores and mass merchandisers are able to pass cost savings onto the consumers via lower prices, while still maintaining margins. Large chains like Walmart and Target can also lower prices more readily making it harder to compete on price.

This has caused larger Sporting Goods Store Chains to open “ superstores” that allows them to compete more effectively on price with department stores. Substitutes/Compliments In terms of sports equipment, which is the largest product segment in the industry, market share has declined since 2000 and can be attributed to the growth in the rental market. With declining disposable income levels, it became more cost effective for consumers to rent sports equipment then purchasing it outright. Sale of sports equipment by external competitors like department stores has also accounted for this loss in market share.

Other substitutes that affect this industry have to do with how people spend their leisure time and competition with products such as toys, crafts, fashion, andmusicrelated items exist because of this factor. Home entertainment products also directly compete with sporting and recreational goods depending on how consumers spend their leisure time. With advances intechnologythe competition for these substitutes increases, which holds true in advances in video game systems, computer games, and online resources to spend leisure time.

Buyer Power Buyer power can be seen mostly through the affects that disposable income takes on industry sales. The products that Sporting Goods Stores would not be generally viewed as necessities and therefore sales are hurt when consumer spending takes a downturn due to tightening of disposable income. Fluctuations in income levels among consumers also alters price levels of goods purchased. In continuing with price, price remains the single largest basis of competition between firms within the industry.

Consumers are price conscious and will ensure that they purchase goods at the best possible price. Therefore, buyers have the power to shift pricing points of firms and facilitate competition based on those pricing points. Along with price comes quality and the demand for popular branded items by consumers. Consumer preferences can determine the range of merchandise carried by companies and also the brands that stock the shelves. Therefore changes in consumer preferences greatly affects the products offered to public by consumers and the quality of products offered. Supplier Power

Supplier power within the industry has come mostly in retailers seeking exclusive contracts with them in the hopes that those retailers gain an advantage over rivals with the types of products they are able to offer. For example, Foot Locker, which is more of a sports apparel retailer but nonetheless, has secured specific partnerships with Adidas and Reebok for the back-to-school period. With the partnership Foot Locker became the exclusive retailer of new-release Adidas and Reebok shoe products. This trend of seeking exclusive contracts with suppliers is forecasted to ontinue in the future in hopes of increasing industry revenue. However, this also gives more power to suppliers in terms of which companies they competitively position themselves with. Big Four Analysis Demographics Sports participation rates by age have a pretty solid effect on industry revenue. Children aged 5 to 17 years old are estimated to represent the key market for the industry, comprising of about 53 million individuals. This age group also has the highest participation rates in sports, thus driving sales for this age demographic.

The problem is that as this age group gets older there is a trend of decreases in sports participation in order to focus attention on activities other than sports. The relative size of this market in the five years to 2016 is expected to decrease by 9% because of this changing of activities. Also, as people live longer they want to maintain healthy lifestyles, which is why the aging baby boomers are expected to lead to higher sports participation rates among people 64 years and older. This will have a very favorable effect on the industry given the vast number of individuals that fall within this category.

Sporting Goods Stores are also found to greatly position themselves in areas of the United States most densely populated. The industry is largely concentrated in the Southeast and West regions, which account for 24. and 17. 5% of industry establishments. These two regions also account for the largest share of US population at 25. 2% and 17. 0% respectively. Lifestyle Increases in consumer awareness regarding living healthy lifestyles and incorporating regular exercise into their daily lives is a positive factor for the industry.

This lifestyle thus boosts sports participation rates resulting in increasing revenue for industry players. There has also been recent rise in popularity for sports activities that strengthen the mind-body spiritual connection, which also has a positive effect on the industry. Another key driving factor that has positive results for the Sporting Goods Stores Industry is the nationalcultureof the United States. Sports are a very important part of our nation’s culture whether it be via the professional sports exposure or the team sport participation driven by association with secondary and tertiary schools.

The exposure and the vast amount that sports are imbedded within our every day life create continued positive figures in terms of sports participation. Legal/Regulatory Sports retailers that sell firearms must comply with the Federal Brady HandgunViolencePrevention Act, requiring retailers to perform presale background checks of consumers who want to purchase hunting rifles. Each background check generates a specific transaction number that is recorded on Form 4473 of the Bureau of Alcohol, Tobacco, and Firearms and retained for 20 years for auditing purposes.

In addition retailers must hold a federal firearms license. Retailers are not exposed to tariffs on goods supplied but do have a range of organizations that provide guidance and support to them. Some key examples of such organizations include the National Retail Federation, the American Apparel and Footwear Association, and the National Sporting Goods Association. Technology Some technological advances that have made firms more competitive in the industry include, point of sale systems, bar-code scanning and electronic data interchange.

These enable firms to control merchandising, distribution, sales, and markdowns. Increases in labor productivity have also been a direct result of such technological advances. Establishments of online means of shopping also have given retailers another channel of product distribution and have created further competition. Some technological threats to the industry have to do with shifts in consumer preferences as far as how they spend their leisure time. Wii Sports for Nintendo is an example of this as consumers have shifted to digital games as opposed to physical sports.

The Wii series also offers additions such as Wii Fit and Wii Fit Plus Yoga, which shows the ways in which consumers view sports participation has altered. Technological advances in video and computer games have enhanced the quality, affordability, and experience of undertaking these leisure activities and continued growth in those areas has a drastically negative effect on traditional sporting activities and the Sporting Goods Stores Industry as a whole. Industry Life Cycle The Sporting Goods Stores Industry is currently in the mature stage of their ife cycle, with growth rates failing to outpace the overall economy, the consolidation of the industries players, and the lack of product innovation significant enough to change the industry’s landscape. Maturity in the industry has been supported by competition from department stores and the lack of change in the key buyers and sellers of sporting goods along with a slowdown in the rate of technological advances. Department store competition has caused contraction within the industry, which is typical of a mature industry.

While more affluent firms have been the primary targets for consolidation, the industry also experienced a decline in the number of non-employing operators, such as the small “ mom and pop” stores. Finally, while manufacturers look to continue enhancing product designs and functionality to make products faster, lightweight, more durable, and more versatile, these types of product advancements generally have little impact on the overall growth of the industry. These product advances aren’t the catalyst that can propel this industry into a growth phase.

Sporting Goods Stores as % of GDP (in millions) Year| 2006| 2007| 2008| 2009| 2010| Industry Sales| 38, 132. 60| 39, 980. 40| 39, 826. 80| 39, 000.

00| 38, 385. 70| Sales Growth| -| 4. 8%| -0. 4%| -2. 1%| -1. 6%| Nominal GDP| 13, 398, 800| 14, 061, 800| 14, 369, 100| 14, 119, 000| 14, 582, 400| GDP Growth| -| 4. 95%| 2. 19%| -1. 18%| 3. 28%| Sales as % of GDP| . 285%| . 283%| . 271%| . 272%| . 265%| The industry sales chart that is shown above includes all companies that operate within the Sporting Goods Stores Industry, from major players to small and specialty stores.

From the data above we can see that revenue growth for the industry has lagged behind Nominal GDP growth. Supporting the notion that the industry is in the mature stage. This was most likely caused by the fact that growth in the industry over the previous five years was hit hard by declines in consumer spending and consumer deleveraging. Declines in consumer confidence and consumption levels seemed to affect Industry revenue than Nominal GDP as a whole. Sporting Goods Stores Companies with over $250 million in Sales as % of GDP (in millions) Year| 2006| 2007| 2008| 2009| 2010|

Industry Sales| 9, 705. 20| 11, 404. 40| 11, 881. 10| 12, 265. 80| 12, 838. 50| Sales Growth| -| 17. 5%| 4. 18%| 3. 24%| 4. 67%| Nominal GDP| 13, 398, 800| 14, 061, 800| 14, 369, 100| 14, 119, 000| 14, 582, 400| GDP Growth| -| 4. 95%| 2. 19%| -1. 18%| 3. 28%| Sales as % of GDP| . 00072%| . 00081%| . 00083%| . 00087%| . 00088%| The second chart is the same breakdown as the one before, however it is a make up of only the 7 firms in the industry that receive revenue over $250 million on an annual basis (Sports Authority is included but is privately held so only basic revenue data was able to be retrieved).

What we see now is quite a different story, with industry revenue growth outpacing Nominal GDP growth in all years of the historical breakdown. This suggests that the large cap firms within the industry are not as mature in nature as the broad industry and have ample room for growth in the future. This would suggest that based on the forecasts of increased consumer spending/consumption in the future as the economy strengthens and consumer confidence returns, growth figures for these large cap firms will be even higher. Dick’s Sporting Goods Analysis Review of Annual Report Key Risk Factors

The following are some of the risk factors presented from management as their biggest threats in terms of influencing sales. : * Economic and financial downturn causes declines in consumer spending, which will adversely affect the company’s operations. * The business is very seasonal and is highly dependent on the success of the 4th quarter. * The industry is very sensitive to general macroeconomic changes that would affect either consumer sentiment or consumer spending. * The terms of their senior secured revolving credit facility impose certain restrictions that may impair their ability of available capital. The lack of acceptable retail store sites on terms acceptable to Dick’s Sporting Goods, rising real estate prices and other costs related to new store openings could limit expansion plans. * Private brand offerings, which are being emphasized more and more, expose DKS to many other risks than more popular brands. * If inflation were to increase it would greatly affect Dick’s Sporting Goods’ operating results unless DKS was able to fully pass on the increases in costs to the consumer via price. Legal

Proceedings In 2011 Dick’s Sporting Goods has 14 cases ongoing in litigation, which is down from 2010 when there was 39.

One of the cases that received a lot of notoriety recently was Tamara Barrus vs. Dick’s Sporting Goods in 2010. Barrus was a former employee who was suing her former company on claims that DKS failed to pay her wages and failed to compensate her for overtime. The reason this case got so much attention was because as the case drew on, additional claims were added to the case from 35 other states with the same allegations. The settlement ended up being for approximately $10. 8 million before taxes in favor of Barrus and the other defendants.

What is important to note is the potential vast negative effect this could have had on DKS’s reputation as well as the losses they had to pay in court. Off Balance Sheet Arrangements The off balance sheet arrangements for Dick’s Sporting Goods relate to operating leases, future minimum guaranteed contractual payments, and letters of credit. In the annual report, Dick’s Sporting Goods holds a firm stance that these off balance sheet items do not have any material effect on the financial condition of the company, revenues or expenses, results of operation, liquidity, capital expenditures, or other resources.

When looking at the figures however there seem to be a different story. DKS lists $3, 717, 112, 000 in total contractual obligations and $21, 527, 000 in total other commercial commitments that are not listed on their balance sheets. This would definitely seem to affect their operations and liquidity when looking at the magnitude of those numbers. In addition, DKS lists over $200 million in goodwill on its financial statements but its largest subsidiary

Golf Galaxy was determined to have their goodwill unit fully impaired upon further investigation, which calls into question the size of the goodwill figure.

DKS lists $130, 496, 000 in financing leases and $9, 524, 000 in capital leases, the financing leases do not have to be listed in financial statements but as you can see carry a very large amount. Finally, Dick’s Sporting Goods agreed to new terms on its Credit Agreement that allow DKS to incur unlimited capital lease obligations and indebtedness tofinancethe acquisition or improvement of any fixed capital assets. The new agreement also allows Dick’s to increase their ability to incur up to $200 million of unsecured indebtedness. Management

In examining the upper management of Dick’s Sporting Goods there are only a few things that I would like to point out. Edward Stack, whose father founded Dick's, has served as chairman and CEO since1984. One area for concern is the board's staggered terms and the firm's dual-class common stock structure, which includes Class B shares with super-voting rights. Stack owns about 26% of the outstanding shares (including 23 million Class B shares) and controls 66% of the voting power. This drastically limits the control of minority shareholders.

Dick's also has takeover defenses in place to prevent potential suitors from acquiring the firm. Executive compensation is weighted toward Stack, who received more than $7 million in total compensation over the past two years while the other top four officers received between $3. 8 and $1. 2 million. Salaries, all less than $1 million, are relatively small in the executive compensation system, but stock awards and stock options have been generously given and have consistently increased share counts. The dealings of the CEO and hisfamilyare also means for concern.

Company SWOT Analysis Strengths Store-within-a-store merchandising concept With this type of merchandising model Dick's Sporting Goods is able to gain advantages as a large store as well as that of a specialty store. Each of DKS's large 50, 000-75, 000 square foot buildings it has specialty stores including: Golf Pro Shops, Footwear Centers, Fitness Centers, Outdoor Centers, and Team Sports. Deep product selection and knowledgeable staff are two advantages that DKS is able to provide with these specialty shops.

These stores focus on specific categories and carry very deep products selections within each area of interest. The area that hurts specialty stores is competing on price but since DKS is also a mass merchandiser it is able to be competitive on price in that aspect. The combination of these two types of stores increases the average spend, customer satisfaction, price competitiveness, and product selection. Leading Market Position Garnered from Competitive Pricing Dick's Sporting Goods is the leader in market share in the industry capturing about 13. 4%.

The small number of large cap firms in the industry create an attractive competitive dynamic for these companies, as they have better bargaining power and can pass on the benefits of this large scale to customers in the forms of lower prices and higher quality merchandise. At the end of fiscal year 2011 DKS operated 486 stores and has growth plans set in the motion to increase that number at a staggering rate. A key aspect that has fueled its market position is its price positioning. DKS maintains a policy of matching competitor’s advertised prices and maintains the notion of providing value at each price point.

Weaknesses Strained Relationship with the Employees Dick’s Sporting Goods has been involved with labor issue lawsuits over the past few years. Claims by former employees of failing to pay wages and overtime wages and various class action lawsuits. These not only deteriorate the relationships between corporate and lower level employees but also result in financial loss and gives a hit to the company’s overall reputation. Opportunities Increased Health Consciousness As mentioned in the lifestyle section, the health and wellness trend is expected to gain tons of momentum in the coming years.

Industry analysis shows that yoga, aerobics, tennis, hiking, and running/jogging were the top five sporting activities that people were involved in 2010. Growing participation in these areas can be attributed to growing public awareness and emphasis on the benefits of a healthy lifestyle. In order to take advantage of this DKS can push its exercise/fitness equipment areas and fitness apparel lines, which would directly benefit in sales from higher participation in those five sporting areas mentioned. Offering Merchandise with Higher Margins in order to Enhance Profitability DKS has been ontinually improving profitability by offering higher margin merchandise such as apparel and footwear. In 2010, DKS incorporated Nike Field House shops at its retail outlets and plans to open 100 Nike Field House shops at its stores by the end of 2011. By partnering with manufacturers who are trying to push these types of products, DKS stands to benefit by way of product differentiation and product exclusivity as it is Nike’s key strategic apparel partner. More initiatives such as this will stand to boost profitability for DKS and will increase its return on investments. Threats Lower Participation in Golf

Primarily due to the economic slowdown there has been a decline in golf participation in the last few years as club members have not been able to afford the high fees charged by golf clubs. According to estimates participation is down 11. 5% from the year before, which has led to sluggish sales growth in that area for DKS. Gold equipment related purchases decreased 14% industry wide last year, which is a threat to Dick’s Sporting Goods as the revenue from the sale of golf equipment forms an important part of DKS’s total revenue. It also hurts the sales revenue of the 81 Golf Galaxy stores that are owned by Dick’s Sporting Goods.

Non-replicable Characteristic of Products Demand for particular sporting goods equipment depends heavily on the region of the United States and DKS has limited scope in terms of replicating its products across all of its stores because of this. Climate changes play a significant role as well in the merchandising mix to be offered in regions and demands changes in the seasonality of certain products. With these obstacles to deal with, it limits DKS’s ability to have huge gains on inventory even though it is a large retailer. Trend Ratio Analysis Key Growth Ratios, YOY| 2007-01| 2008-01| 2009-01| 2010-01| 2011-01| Revenue %| 18. %| 24. 9%| 6. 2%| 6. 8%| 10. 4%| Net Income %| 3. 6%| 3. 9%| (1. 0%)| 3. 1%| 3. 7%| Dick’s Sporting Goods has had positive growth each of the last five years in terms of revenue, and has had positive growth four of the last five years in terms of their bottom line. This can be attributed to its strong position with the industry in terms of market share and its ability to compete on price as a mass merchandiser and be profitable in terms of its specialty stores. Growth looks to continue in the future for DKS with analysts predicting around 8% growth in fiscal year 2012 and low double digit growth in 2013.

Liquidity/Financial Health| 2007-01| 2008-01| 2009-01| 2010-01| 2011-01| Current Ratio| 1. 5x| 1. 4x| 1. 7x| 1. 5x| 1. 8x| Quick Ratio| 0. 3x| 0. 1x| 0. 2x| 0. 3x| 0. 7x| Cash Conversion Cycle| 59. 5| 66. 8| 71. 4| 62. 5| 51. 3| Receivables Turnover| 90. 2x| 76. 5x| 68. 9x| 94. 7x| 138. 4x| Inventory Turnover| 3. 8x| 3. 6x| 3. 4x| 3. 7x| 3. 8x| Dick’s Sporting Goods’ liquidity ratios seem pretty stable over the past five years. However, the quick ratio is very lower compared to the current ratio because inventory represents such a large part of DKS’s current assets.

Despite this the quick ratio has been increasing over the past four years of operation. DKS’s cash conversion cycle has declined in recent years after extreme growth in the beginning of the last five years. Inventory turnover has been pretty stagnant for Dick’s Sporting Goods and DKS should look to improve this number in order to reduce inventory costs and storage costs. Finally the receivables turnover of Dick’s Sporting Goods has seen great growth in the past five years meaning that it has been doing a better job of collecting on its accounts receivable.

Profitability| 2007-01| 2008-01| 2009-01| 2010-01| 2011-01| Asset Turnover| 2. 3x| 2. 2x| 2. 1x| 2. 1x| 2. 0x| ROA| 9. 1%| 9. 4%| 7. 5%| 7. 0%| 8. 3%| ROE| 21. 8%| 20. 0%| (4. 5%)| 13. 7%| 14. 9%| ROIC| 17. 7%| 18. 0%| 14. 0%| 12. 8%| 14. 7%| Dick’s Sporting Goods’ profitability ratios are down from their beginning levels in this recent five-year period. These are unfavorable trends in terms of investor confidence. Return on Equity is lower than the beginning of the period by 6. 9% and Return on Invested Capital is at 3% lower than fiscal year 2006 levels.

The good note is that all the ratios are improving from the previous year in attempts to return to levels prior to the recession. These ratios will hopefully increase as consumption increases and consumer confidence returns to pre-recessionary levels. Leverage Ratios| 2007-01| 2008-01| 2009-01| 2010-01| 2011-01| Debt/Equity| 29. 2%| 20. 4%| 20. 3%| 13. 1%| 10. 3%| Long-term Debt/Equity| 29. 1%| 20. 4%| 20. 2%| 13. 0%| 10. 3%| Interest Coverage| 18. 2x| 13. 2x| 13. 7x| 51. 9x| 22. 8x| Financial Leverage| 0. 29| 0. 20| 0. 20| 0. 13| 0. 10| Dick's Sporting Gods has approximately $. 3 of liabilities for every $1 of assets. Dick's has also done a very good job of reducing its long-term debt relative to equity in addition to reducing its debt relative to equity. In addition DKS currently covers its interest expenses 22. 8 times with earnings. This is a significant drop from the previous year but it is an overall increase from the beginning of the five years leading to fiscal year 2010. Cross Sectional Ratio Analysis I chose to compare Dick's Sporting Goods with Cabela's Inc. and Big 5 Sporting Goods, which are its two biggest publicly owned rivals in the industry.

All three are industry leaders in many statistical and ratio categories. For comparison sake I will use the most recent fiscal year (2010) for the cross sectional ratio analysis of the three firms. Key Growth Ratios, YOY| DKS| CAB| BGFV| Revenue %| 10. 4%| 4. 3%| 0. 1%| Net Income %| 3. 7%| 5. 0%| 2. 3%| In looking at the year-over-year key growth ratios, Dick's Sporting Goods' revenue is more than double above Cabela's and substantially higher than Big 5 in the most recent fiscal year. DKS is only second however in year-over-year net income, losing out to its closest industry competitor Cabela’s Inc.

Liquidity/Financial Health| DKS| CAB| BGFV| Current Ratio| 1. 8x| 2. 0x| 1. 8x| Quick Ratio| 0. 7x| 1. 6x| 0. 1x| Cash Conversion Cycle| 51. 3x| 76. 4x| 100. 3x| Receivables Turnover| 138. 4x| 61. 0x| 63. 2x| Inventory Turnover| 3. 8x| 3. 3x| 2. 5x| The current ratios for the industry leaders are pretty similar across the board and CAB is the leader of the three in terms of quick ratio with DKS in second. In terms of receivables turnover, Dick’s Sporting Goods is much more efficient in collecting on its accounts receivable than either CAB or BGFV, however DKS is last of the three in its average cash conversion cycle.

Finally, DKS is has the best inventory turnover among the top three public players of the industry meaning that it is more efficient in reducing its inventory costs and DKS does a better job of getting its products off the shelves and into the customer’s hands. Profitability| DKS| CAB| BGFV| ROA | 8. 3%| 3. 4%| 5. 9%| ROE| 14. 9%| 11. 2%| 14. 6%| ROIC| 14. 7%| 5. 1%| 11. 3%| Profitability measures of the industry’s three largest players shows that Dick’s Sporting Goods earns greater income off of their equity relative to its two competitors.

Return on Assets and Return on Invested Capital also favor DKS in comparison to its peers. Leverage Ratios| DKS| CAB| BGFV| Debt/Equity| 10. 3%| 227. 4%| 34. 4%| Long-Term Debt/Equity| 10. 3%| 120. 8%| 33. 1%| Interest Coverage| 22. 8x| 9. 5x| 25. 8x| Financial Leverage| 0. 10| 4. 42| 2. 60| As you can see Dick’s Sporting Goods is a much less levered company in comparison to its two largest competitors. It has drastically lower debt to equity ratios and a dramatically lower financial leverage statistic. This make Dick's Sporting Goods a less risky company in comparison to Cabela's Inc. and Big 5 Sporting Goods Inc.

However, DKS's beta is slightly greater than one; around 1. 24, which means that its is riskier than the market. Analyst Analysis/Estimates A key factor in DKS's merchandising strategy is strong vendor relationships. Most mass merchants and specialty retailers have limited access to sports equipment because they can't offer the high level of service that manufacturers demand from the firms they supply to. The store-within-a-store layout however Dick's Sporting Goods provides that high level of service through experienced professionals, value-added repairs, maintenance, and assembly services.

There is also an interactive shopping experience for customers with them being able to try products out before purchase, which most competitors don't match. Dick's has a great opportunity to expand nationwide in terms of number of storefronts and overall market share. Management has identified the potential for at least 900 DKS stores in the US before it nears saturation, which means that as of right now Dick's is only halfway to its ultimate goal in terms of store base. It's estimated that Dick's Sporting Goods will open on average 36 new stores per year in the near future, suggesting a mid/high single digit square footage growth rate.

In the long run, analysts expect more M&A similar to the acquisition of Golf Galaxy in order to provide immediate market penetration into several new markets. These types of acquisitions will also give DKS a better understanding of local markets, which will allow for DKS to adjust for regional preferences as discussed earlier. Dick’s Sporting Good’s category-leading inventory turns and high profitability within the industry will likely produce enough cash to fund its store growth initiatives in the near future.

This will prevent DKS from having to turn to capital markets or the use of levering up. This will allow the firm to remain one of the industry’s healthiest companies financially. Analysts give Dick’s Sporting Goods a Fair Value Estimate of $41 per share, which is an increase from prior estimates based off of longer term operating margin assumptions. In terms of comparable ratios for valuation, analysts’ fair value estimate implies 22 times forward earnings, 9 times enterprise value to EBITDA, and 3% free cash flow yield.

In terms of operating margin, analysts estimate that it will be on average between 8%-9%, which is a conservative estimate compared to company estimates of double-digit margins in the next three to five years. The model that the Morningstar analysts are using takes into account the growth plans that Dick’s Sporting Goods has in the future in terms of store openings at an average of 35 per year and that the chain reaches a total store count of more than 800 in the next 10 years at the end of the forecast.

For fiscal year 2012, the model gives just under 8% growth in revenues, continued leverage of operating margins are to reach 8% on both gross margin improvement and SGA leverage. In 2013, analysts project low double-digit growth on a faster store-opening rate and slightly improved same-store sales along with flat operating margins as percentage of revenue. DuPont Ratio Analysis Over the most recent five-year period, Dick’s Sporting Goods saw drastic decreases in Return on Equity and moderate decreases in Return on Assets.

By breaking down these ratios into the Dupont formula we can see what played a part in these decreases. Return of Assets= Net Income/Total Assets= Profit Margin*Asset Turnover | 2007-01| 2008-01| 2009-01| 2010-01| 2011-01| ROA= NI/TA| 9. 1 %| 9. 4 %| 7. 5%| 7. 0%| 8. 3%| Profit Margin= NI/Sales| 20. 93%| 20. 68%| 15. 75%| 14. 7%| 16. 6%| Asset Turnover= Sales/TA| 2. 3| 2. 2| 2. 1| 2. 1| 2. 0| From dissecting Return on Assets further we see that the main contributor to the decreasing ROA was the decreases in profit margin from the beginning of the most recent five-year period.

Profit margins were cut because due to decreases in consumer spending during recessionary periods, Dick’s Sporting Goods was forced to cut its prices while input costs remained high, thus narrowing margins. Asset turnover was reduced during this five year period but not at a significant enough rate to be a major contributing factor to the massive decreases in Return on Assets. We now look at the Return on Equity based on the Return on Assets computations. | 2007-01| 2008-01| 2009-01| 2010-01| 2011-01| ROE= ROA*TA/EQ| 21. 8%| 20. 0%| (4. 5%)| 13. 7%| 14. 9%| Fin. Lev= TA/EQ| 0. 29| 0. 0| 0. 20| 0. 13| 0. 10| With the financial leverage decreasing because of there being less equity in the market as the recession continued after 2007, in order for Return on Equity to increase the ROA needed to offset that decrease in financial leverage. As we saw before, due to the drastic drops in profit margin over the period the Return on Equity suffered also. Therefore, variability in ROE can be attributed to volatility in the Return on Assets of Dick’s Sporting Goods. (Some of the values are not exact because of miscalculations in on the part of the Capital IQ database).

Valuation P/E Multiplier The current P/E for Dick's Sporting Goods is 20. 1. Since the economic outlook calls for expansion I will use the average annual growth of earnings from 2002-2007, which was deemed an economic expansion era. The average annual earnings growth rate over this time period is 24. 084%. This is a realistic estimation because if the economic forecast proves correct the we would experience a similar type of growth as we did post Internet bubble crisis, which is right around the beginning of 2002. Dick's Sporting Good's current earnings per share is $1. 92.

Therefore, in order to get estimated earnings you take the current earnings per share and multiply it by the average annual growth rate of earnings during economic expansionary times. This gives us estimated earnings of $1. 92*(1. 24084)= $2. 3824. From there we multiply expected earnings per share times the current price to earnings ratio in order to get the intrinsic value based on this valuation model. Therefore we take 20. 1*$2. 3824 to get an intrinsic value of $47. 886. The current stock price of DKS is $38. 53 (as of 11/29/11). This would suggest that the market undervalues DKS by about 19. 54%.

Free Cash Flow to Equity Approach In using the free cash flow to equity approach there are many inputs in which you need to identify and defend their use. Here are some of those inputs: * WACC= 11. 64%; This was based off of a WACC calculator in which total debt and total equity were extracted from the most recent financial statements, corporate tax was 38. 8% based on public information, cost of debt was 7. 0% based on analyst information, and cost of equity was found using CAPM. For risk free rate the 3 year treasury rate was used of . 4% and for market return the 3 year return on the

Russell Midcap Growth Index of 10. 8% was used because that is the style of stock DKS is and 3 years after analyst growth estimates for 2012 and 2013 is when we expect economic expansion. * 2012 growth rate is 8% based on analyst estimates and 2013 growth is 11% based on analyst estimates. * From 2014 until 2016 we expect there to be growth but at a decreasing rate of about 1. 5% per annum until after 2016 when we expect growth to mimic economic expansion from 2002-2007 in which the average annual growth rate was 6. 31%. Calculation of Intrinsic Value on Following Page Year| FCF/Share| 2002| . 3902| 2003| . 3168| 2004| . 0283| 005| . 3412| 2006| . 0541| 2007| . 7692| 2008| -. 5089| 2009| 2. 2119| 2010| 1. 8934| 2011| 2. 032| 2012| 2. 19456| 8% growth| 2013| 2. 43596| 11% growth| 2014| 2. 66737| 9. 5% growth| 2015| 2. 88077| 8% growth| 2016| 3. 06802| 6. 5% growth| Perpetuity| 61. 1934| 6. 31% growth| Intrinsic Value| $41. 0685| The current stock price is $38. 53 (as of 11/29/11), and based on the intrinsic value this suggests that the market undervalues DKS by about 6. 18%. Summary of Analyst Reports According to Morningstar Investment Research Center, the fair value estimate for Dick’s Sporting Goods is $41. 0. In addition, analysts recommend to consider buying the stock at $24. 60 and consider selling the stock at $63. 60. Morningstar also gives Dick’s Sporting Goods a three star rating. In looking at YahooFinance the mean target for the stock based on analyst estimates is $46. 50 with a high target of $50. 00 and a low target of $36. 00. Accordingly, this month there are 10 Strong Buy recommendations, 7 Buy recommendations, 9 Hold recommendations, and 1 Underperform recommendation. Beta Coefficient Dick’s Sporting Goods has a Beta coefficient of 1. 4, indicating that it is generally more risky than the general market. This risk factor is most likely determined by the high revenue volatility that the industry is exposed to as a direct result of consumer spending and also due to the industry’s mature state. Technical Analysis In examining Dick’s Sporting Goods using technical analysis I chose to pick a few popular technical analysis indicators and use them to assess DKS. First we look at Bollinger Bands, which are variable width bands that become narrower during less volatile periods and wider during more volatile periods.

In examining the Bollinger Bands for DKS we can see that as of right now there seems to be low levels of volatility in pricing especially compared to August where there was much volatility in pricing for DKS along with the overall market. The recent lower volatility would suggest stable pricing trends to continue in the near future. Next I looked at the Relative Strength Index. The RSI is a calculation where average up and average down are calculated using a simple average method for the initialobservation. Subsequent values are computed using these initial values in conjunction with a damping factor to smooth out extreme points.

An RSI indicator falling below a value of 30 indicates an oversold condition. A buy signal is triggered when the indicator crosses 30 from below. Similarly, an RSI value greater than 70 indicates an overbought condition. A sell signal is triggered when the indicator crosses 70 from above. If you look at the bottom half of this picture you can see the Relative Strength Index for the current year. In going with the description on the previous page, it seems that in late August/early September the RSI crossed 30 from below, which would have signaled a buying situation at the time.

In looking at other technical analysis trends, financial visualizations or FINVIZ. com, gives distance from simple moving average statistics. The SMA50, or the distance from the 50 day simple moving average is 3. 25%, which according to the site is a favorable statistic. In addition it states that the SMA200 or the distance from the 200 day simple moving average is 2. 28%, which is once again a favorable statistic according to the site. Conclusions * Dick's Sporting Goods has the leading market share in a mature Sporting Goods Stores industry that's marked by high levels of pricing competition. The industry is very dependent on consumer spending and disposable income per capita. Decreases in these along with consumer confidence pose huge threats to the industry as we saw with the extremely marginal average annual growth from 2006 to 2011. * DKS is the leader in the golf industry with its acquisition of Golf Galaxy and its us of the store-within-a-store model for specialty golf stores. * The industry is seeing decreases in sports participation among children in lieu of other avenues to fulfill leisure time that could put restraints upon growth within the industry. Dick's Sporting Goods' high lease expense represents off-balance-sheet financing and means the company is more leveraged than investors realize. * DKS has benefitted from its ability to compete on price as a mass merchandiser and from offering deep product selection and higher margin items within it's specialty stores. * Management has store expansion plans that on average would open up about 35 new stores per year and would put Dick's Sporting Goods over 800 stores within the 10 year forecast, which is just under the estimate for number of stores until saturation. -- [1]. Zumbrun, Joshua. " Fed Says Economy Has Picked Up While Still Detecting ' Significant' Risks. " Bloomberg -

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