Off Wall Street

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New Rec: Dick's Sporting Goods (DKS: $59.13) Sept. 28, 2016

Position: Sell **Target: $39.00**

$MM	3Q16e	4Q16e	1Q17e	2Q17e	F2016e	F2017e
Revs	1,761.5	2,431.0	1,783.9	2,102.2	7,820.7	8,314.7
EPS $	0.40	1.29	0.56	0.89	3.01	3.26
Y/Y Gr	-1%	14%	12%	9%	6%	9%
PE	na	na	na	na	19.6	18.1
Cns Revs	1,764.6	2,440.5	1,822.0	2,172.0	7,833.3	8,551.0
Cns EPS $	0.42	1.31	0.63	1.00	3.05	3.71

Shares Out: 112.1 MM **Market Cap: 6.63B** **FYE: January**

Concept:

1. New store sales and profitability could fall short of "street" expectations due to disappointing brick & mortar traffic as a result of inter-channel cannibalization and increased competition from online merchants.

2. The operating margin expansion anticipated in FY2017 may not occur due to fixed cost deleveraging, gross margin pressure and costly relocations to smaller format stores.
3. U.S. sporting goods sales now appear to be concentrated mainly among a group of large vendors and retailers. Therefore, the opportunity for DKS to take substantial market share via consolidation may be smaller than expected.
4. Competition in certain high margin sports equipment categories and in the fast growing, high margin athletic apparel market (35% of DKS' sales) is intensifying. Price competition and increased promotional activity should further pressure operating margins.

Summary: Dick's Sporting Goods, Inc. (DKS) is a leading retailer of sporting equipment, apparel and footwear. The company was founded in 1948, and is based in Coraopolis, PA. At F2Q16 quarter end (July 31, 2016), the company had 649 Dick's Sporting Goods stores in 47 states, 72 Golf Galaxy stores in 29 states, 21 Field & Stream stores in 10 states, 3 True Runner stores in 3 states and 2 Chelsea Collective stores in 2 states.

Despite posting negative SSS growth in FY2015 and a 3-year EPS CAGR of just 7%, bullish "street" analysts believe the recent upward revaluation of DKS share price to an all-time high is justified based on the combination of new unit growth visibility over the next several years, near-term optimism regarding the company's e-commerce transition to in-house, and the long-term opportunity for DKS to substantially grow its market share as the industry consolidates and as competitors like TSA go bankrupt. Bullish analysts point to the opportunity to capture considerable market share from the consolidation of the industry and the recent Chapter 11 bankruptcy of The Sports Authority (TSA) as reasons to expect 3%+ SSS growth, double digit earnings growth and a premium PE multiple relative to the company's 3-year historical average multiple of 14.5X.

DKS management has proposed that the company can substantially increase sales from about $7.3B in FY15 (ended January 2016) to about $12B by FY20 (ends January 2021). In order to achieve this goal, management plans to open 225-250 net new stores over the next 5 years, or about 45-50 stores per year. The states in which Dick's plans for the greatest number of new stores are California, Texas, Florida and New York, where the company believes it can open more than 100 new stores. The notion is that DKS will become the dominant "omni-channel" sporting goods retailer in the US through a combination of new stores and increased online sales, resulting in its market share growing from the current 11% to a mid-teens percent share. We think that this will be difficult to accomplish.

First, while DKS' debt free balance sheet and positive cash flow may provide the company with the means to grow sales by opening new stores, we think DKS will be challenged to grow sales and operating margins simultaneously, as bulls expect. We expect new store sales productivity at DKS and overall company profitability to be lower than "street" bulls anticipate.

Our research indicates that increased e-commerce penetration in the U.S. sporting goods market from online competitors as well as from DKS' own omni-channel strategy may be contributing to reduced in-store traffic levels at both new and existing stores, as more consumers migrate online and make less frequent trips to DKS brick and mortar stores. For example, while sales growth through its e-commerce channel is up 145% in the three years since 2012, sales per square foot at DKS's brick and mortar stores declined from $193 in 2012 to $181 in 2015. We think this inter-channel sales cannibalization could result in lower new store sales productivity, lower gross margins due to higher variable costs (shipping) and fixed cost deleveraging. Furthermore, fixed cost deleveraging at DKS could result in more store closings and/or costly relocations to smaller format stores, potentially resulting in lower square footage growth than "street" bulls anticipate.

In addition to lower than anticipated new store productivity from inter-channel cannibalization and lower gross margins from fixed cost deleveraging and higher shipping costs, wage inflation may offset anticipated cost savings initiatives, also resulting in lower than expected operating margins in FY2017. The average salary at DKS may have to move higher to compete with Wal-Mart and other service oriented retailers. Furthermore, the Fair Labor Standards Act (FLSA) minimum salary requirements that go into effect December 1, 2016 may result in additional wage pressures at DKS in FY17.

The opportunity for DKS to take market share may be more challenging than bulls believe. Based on our research, it appears that the top 25 retailers make up more than 98% of total revenues in the U.S. sporting goods industry. In recent years, the industry has become more concentrated as many new, large competitors entered the U.S. sporting goods market, including vendors like Nike, department stores like Kohl's, and online aggregators like Amazon.

Based on our assessment of the U.S. sporting goods market, it does not appear that there are many large consolidation opportunities remaining among the top players in the industry. Therefore, DKS will be forced to take market share mainly from existing, established competitors. Taking share from existing, large players may be more difficult and more costly than bulls expect.

Furthermore, our research indicates the competitive environment is intensifying, especially in certain high margin, fast growing sporting goods categories like team sports equipment and athletic apparel. The recent proliferation of specialty sports retailers like Pure Hockey, ComLax, Monkey Sports and others may be an underestimated threat to sales of team sports equipment at DKS.

Also, maturing growth in the "athleisure" trend, coupled with the proliferation of athletic apparel suppliers and retail channels suggests the active wear market may be nearing saturation. As discussed in greater detail in discussion point 3, the sporting goods market is undergoing a meaningful transition, with many new vendors and retailers entering the market, and with existing vendors like Nike, Under Armour, Columbia Sportswear and others expanding distribution online through Amazon, with department stores like Kohl's, and increasing market share through their own direct to consumer (DTC) channels. As a result, competition in the athletic apparel market (35% of total sales at DKS) is set to intensify for DKS, potentially pressuring sales growth and margins at the company.

We expect revenue of $7,821M in FY2016 and $8,315M in FY2017, compared to "street" expectations of $7,833M and $8,551M. We forecast adjusted operating profit margin of 7.0% in FY2016 and 6.9% in FY2017 versus "street" consensus expectations of 7.0% and 7.6%. Finally, we look for EPS of $3.01 in FY2016 and $3.26 in FY2017 versus the "street's" forecast of $3.05 and $3.71. Our target of $39 is approximately 12.0x our FY2017 EPS estimate, in line with the average forward year PE of a peer group of secularly challenged specialty retailers and department store mall anchors.

Borrow information: DKS

Supply Quantity	Quantity On Loan	Available to Borrow	Date
25.364mm	0.685mm	24.983mm	9.28.2016

Source: Markit/Data Explorers

Background:

Founded in 1948, DKS is a leading retailer of sporting equipment, apparel and footwear. The company operates retail stores under several brand names, including Dick's Sporting Goods, Golf Galaxy, Field & Stream, True Runner and Chelsea Collective. In addition to its retail stores, DKS sells products through e-commerce websites at www.dickssportinggoods.com, www.golfgalaxy.com, www.fieldandstreamshop.com and www.caliastudio.com. At F2Q16 quarter end (July 31, 2016), the company had 649 Dick's Sporting Goods stores in 47 states, 72 Golf Galaxy stores in 29 states, 21 Field & Stream stores in 10 states, 3 True Runner stores in 3 states and 2 Chelsea Collective stores in 2 states.

DKS generated sales of $7.3B in FY2015 (ended January 2016), implying the company has ~11% market share of the ~$66.3B U.S. sporting goods market, as measured by the National Sporting Goods Association (NSGA). DKS competitors include other full-line sporting goods retailers such as Academy Sports & Outdoors (~7% market share), mass merchandisers such as Wal-Mart (~15% market share), vendors such as Nike (~4.5% market share), specialty retailers such as Foot Locker (~8% market share), specialty outdoor retailers like Cabela's (~ 6% market share), e-commerce channels like Amazon (~4% market share), and department stores such as Kohl's (~4.5% market share).

DKS classifies merchandise sales into 3 categories. The apparel category consists of athletic apparel, outerwear, and sportswear designed for a broad range of activities and performance levels, as well as apparel for specific sports in men's women's and kid's assortments. Technical and performance specific apparel includes offerings for sports such as golf, tennis, running, fitness, soccer, baseball, football, lacrosse, hockey, swimming and cycling. Basic sportswear includes T-shirts, shorts, sweat suits and warm-up suits.

The footwear category consists of athletic shoes for running, walking, tennis, fitness, cross training, basketball and hiking. It also includes specialty footwear, including casual footwear and a complete line of cleated shows for baseball, football, soccer and lacrosse. Other important product lines within the footwear category include boots, socks and accessories.

The hardlines category includes equipment for team sports, outdoor recreation, hunting, golf, fitness, and cycling. In team sports, DKS sells equipment and accessories for team sports such as football, baseball, softball, basketball, hockey, soccer, lacrosse and tennis. In outdoor recreation, DKS merchandise assortment includes equipment for hunting, fishing, camping and water sports. DKS golf offerings include golf clubs and club sets, bags, balls, teaching aids and accessories in addition to a complete range of golf services, including custom club fitting, club repair, and grip and shaft installation for drivers, irons and putters.

In recent years, the sales mix at DKS has shifted from hardlines to apparel and footwear (see Table 1). In 2014 and 2015 the company reduced floor space dedicated to fitness equipment, golf and bikes and made significant investments to broaden its active wear offerings through "store-within-a-store" concepts (CALIA, Nike Field Houses, RL Sport, etc.), a move that DKS management described as a key driver of SSS growth in 2014 and 1H15.

Table 1: DKS Sales by Product Category

(Amounts in $M)	2009	2010	2011	2012	2013	2014	2015
Hardlines	2,453	2,619	2,695	2,964	3,030	2,992	3,264
Apparel	1,251	1,382	1,504	1,685	1,867	2,461	2,553
Footwear	709	870	982	1,150	1,273	1,316	1,403
Other	0	0	31	37	43	45	51
Total	4,413	4,871	5,212	5,836	6,213	6,814	7,271
Hardlines as a % of net sales	55.6%	53.8%	51.0%	50.0%	49.0%	44.0%	45.0%
Apparel as a % of net sales	28.3%	28.4%	28.9%	29.0%	30.0%	36.0%	35.0%
Footwear as a % of net sales	16.1%	17.9%	18.8%	20.0%	20.0%	19.0%	19.0%
Other as a % of net sales	0.0%	0.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company reports

While "street" bulls appear to believe that the company's increased emphasis on apparel and footwear has been self imposed and should boost gross margins, we are skeptical. We think some of the shift away from hardline products resulted from market share losses to competing e-commerce channels such as Amazon in fitness and other hardline categories.

Furthermore, we suspect the recent "athleisure" growth trend may have helped drive apparel sales at DKS in recent years and influenced management's decision to increase its assortment of active wear for women and launch its Chelsea Collective stores in 2015. The March 2015 launch of CALIA, DKS private label brand marketed by Carrie Underwood, is further evidence of DKS recent heightened focus on the women's active wear category. As discussed in greater detail in discussion point 2, DKS increased exposure to the athletic apparel category, and more specifically active wear for women, may open the company up to more intense competition in the year ahead, as the "athleisure" trend appears to be maturing and nearing saturation.

Over the last year, several of DKS' sporting goods retail competitors filed for bankruptcy, including The Sports Authority (~3.5% market share), Sport Chalet (<1% market share) and City Sports (<1% market share). According to DKS management, the company intends to aggressively pursue the market share opportunity as a result of recent bankruptcies in the industry.

On July 20, 2016 DKS announced the company purchased The Sports Authority (TSA) intellectual property assets (website, brand names, etc.) and the rights to acquire 31 TSA store leases, including ~20 located in CA and FL. While DKS does not intend to acquire all 31 TSA store leases, we expect the acquisition to accelerate the company's new store openings to 62 stores in FY2017 as compared to 47 new stores in FY2016.

While "street" bulls believe recent competitor bankruptcies create a near term opportunity for DKS to increase its market share in FY2016 and FY2017, we are skeptical. As discussed further in discussion point 3, intensifying competition in certain key categories such as athletic apparel and sporting equipment may mitigate near term market share gains, while secular threats from vendor disintermediation and e-commerce may accelerate market share loss at DKS in the long term.

Discussion:

1. New store sales and profitability could fall short of "street" expectations due to a reduction in brick & mortar traffic from inter-channel cannibalization and increased online sales of sporting goods products.

DKS management believes the company can substantially increase its market share from ~11% in 2015 to a mid-teens percent share over the long term and become the dominant sporting goods retailer in the U.S. To accomplish this market share goal, DKS plans to execute an aggressive new store growth strategy that will eventually see the company operating 1,100 stores in the U.S., up from 747 at the end of FY2Q (ended July 2016).

"Street" models assume DKS will open 225-250 net new stores over the next 5 years, or about 45-50 stores per year. Assuming square footage of 50K per store on average, the "street's" unit growth projections imply DKS will achieve net square footage growth of 5.5%-6.0% per year. Partly as a result of the company's square footage growth plans, "street" bulls view DKS as one of the best growth stories in hardline retailing.

While DKS' long-term market share, sales and unit growth projections seem aggressive, especially in light of what we estimate is an intensifying competitive environment (see discussion point 4), we acknowledge that DKS' debt free balance sheet and positive cash flow should provide the company the means to grow sales by opening new stores. Nonetheless, DKS may be challenged to grow sales and operating margins simultaneously, as bulls expect. Over the long-term, some "street" analysts forecast operating margins at DKS to expand to 9.0% or more, matching the previous peak set in FY2012. We expect new store productivity and overall company profitability to fall short of "street" expectations.

Our research indicates that online sales of sporting goods products and DKS' own omni-channel strategy may be contributing to reduced in-store traffic levels at company stores, as more consumers go online and make less frequent trips to DKS brick and mortar stores. The resulting fixed cost deleveraging at DKS could result in more store closings and/or costly relocations to smaller format stores than "street" bulls anticipate.

At the 2015 Analyst Meeting held in April 2015, DKS CEO, Ed Stack, announced a slowing in the pace of new store openings and shared a view that 20% or slightly greater than 20% of sporting goods would eventually be sold via the Internet. Nike, DKS largest supplier, is equally enthusiastic about online penetration in the sporting goods market. At its Investor Day held in October 2015, NKE forecasts its online sales to grow from $1.2B, or ~4% of total sales in 2015 to $7B, or ~14% of sales by 2020, potentially positioning NKE as the most significant online competitor to DKS, ahead of Amazon with an estimated $2.7B in annual sales of sporting goods in 2014. By comparison, e-commerce sales at DKS accounted for 10.3% ($749M) of total company sales in 2015.

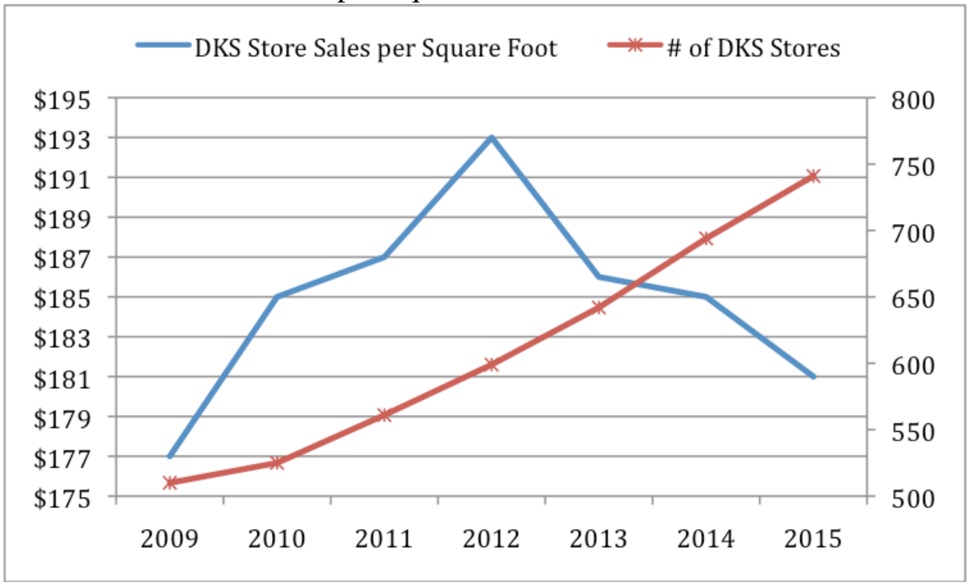
According to DKS' CEO, "it's time to be a bit more prudent about where we're putting stores and how much we're going to cannibalize, because this really is an evolving marketplace from an e-commerce standpoint." In conjunction with its revised outlook regarding e-commerce penetration, DKS management revised its annual unit growth outlook lower from 7%-8% to 5.5%-6.0%, stating that the company needed to be more cautious regarding new store sales cannibalization of its existing store base. DKS forecast for total sporting goods industry online sales penetration suggests the brick and mortar business may not be as well insulated from the threat of vendor DTC channels, Amazon and other e-commerce competitors as bulls think.

In 2009, DKS embraced an "omni-channel" strategy, and in recent years invested heavily in e-commerce (~$100M) to defend against emerging online competitors in sporting goods and to develop its own e-commerce channel. Similar to the dislocation experienced by department store anchors, Best Buy, Pier One and other "omni-channel" retailers, DKS may be experiencing significant sales and margin pressure at its brick and mortar stores from the rapid, secular shift in business mix from brick and mortar to e-commerce.

According to a retail industry observer with whom we spoke, the primary problem with an omni-channel strategy like the one DKS follows is that the e-commerce channel can reduce the need for customers to visit the retail store. The convenience of online shopping means that fewer customers are using stores like DKS as their primary channel for making purchases. In-store demand for certain product categories tends to decline as consumer demand for those items transitions online, resulting in lower in-store sales. Furthermore, the reduced in-store traffic has a negative knock-on effect on other in-store product categories, often forcing the retailer to shrink its store format.

In fact, beginning in 2012, as online functionality at DKS branded websites improved, it appears existing customers slowly migrated online, depleting traffic and spending at DKS' brick and mortar stores. According to company filings, sales per square foot at DKS brick and mortar stores declined from $193 in 2012 to $181 in 2015 (see Chart 3), suggesting in-store traffic and brick and mortar store productivity is declining.

Chart 3: DKS Store Sales per Square Foot & Number of Stores



Source: Company filings

Similarly, as show in Table 2, we estimate SSS growth at DKS brick and mortar stores turned negative in 2013 and declined for 7 quarters in a row from F3Q14 to F1Q16.

Table 2: Estimated Brick & Mortar SSS Growth at DKS (FQ3 14 – FQ2 16)

	FQ3 14	**FQ4 14**	**FQ1 15**	**FQ2 15**	**FQ3 15**	**FQ4 15**	**FQ1 16**	**FQ2 16**
Consolidated SSS $	15.4	65.9	14.4	19.4	6.3	(51.6)	7.1	49.8
E-commerce SSS $	20.4	73.5	32.3	26.7	20.0	40.6	19.7	34.2
Est. B&M SSS $	(5.0)	(7.6)	(17.9)	(7.3)	(13.7)	(92.2)	(12.6)	16.2
Est. B&M SSS Growth	-0.4%	-0.4%	-1.3%	-0.5%	-1.0%	-5.0%	-0.9%	1.0%
New Store Productivity	96.2%	94.7%	95.4%	96.5%	97.4%	97.0%	95.0%	94.0%

Source: Company documents, OWS estimates

Despite evidence that sales productivity at DKS' brick and mortar stores is in decline due to inter-channel cannibalization from increased online penetration of the U.S. sporting goods market, "street" bulls insist that new store productivity at Dick's Sporting Goods branded stores remains above 90% (see Table 2), suggesting new stores sales are performing well. This claim may not be as helpful to investors as they might think. This new store productivity ratio, as reported by DKS, may actually obscure the sales deterioration at the company's new and existing brick and mortar stores.

Note that the new store productivity ratio reported by DKS is calculated by comparing the LTM sales per gross square foot for new stores with the LTM sales per gross square foot for stores included in the SSS calculation, excluding e-commerce sales. Since overall brick and mortar sales per square foot is in decline (see Chart 3), while DKS' reported new store productivity ratio has remained relatively steady (see Table 2), it appears, then, that DKS' new stores are experiencing a similar rate of sales productivity deterioration as the stores in the comp base. As a result, dollar sales per new store may be eroding at a faster pace than "street" bulls forecast.

Due to increased migration of customers online and intensifying competition in athletic wear (see discussion point 4), sales per square foot at DKS' brick and mortar stores should remain under pressure, potentially pressuring profits per store more than bulls anticipate. Furthermore, the new stores in CA, TX, FL & NY, where DKS believes it can open 100+ stores, may be less productive than bulls expect due to more entrenched competitors in these states. We note that Big 5 Sporting Goods has a significant presence in CA, Academy Sports, Cabela's & Bass Pro Shops are entrenched in TX and FL and Amazon has its largest concentration of DCs in CA, TX, FL and NY.

2. The operating margin expansion anticipated in FY2017 may not occur due to fixed cost deleveraging, gross margin pressure, and costly relocations to smaller format stores.

In addition to lower in-store traffic as a result of shifting sales between channels, the migration of existing customers online is resulting in a shift in DKS expense structure, resulting in a deleveraging of fixed costs, and higher variable costs (shipping, marketing, e-commerce investments, etc.). Similar to many department store chains, DKS appears to be struggling with the transition from a largely predictable, fixed cost store operating model to a more complex mix of fixed cost brick and mortar channel and variable cost online channel infrastructure.

For example, in the 3 years since FY2012, DKS grew sales ~25% driven primarily by a ~23% increase in its store base. During this same 3-year period, gross profits at DKS increased nearly 19% while EBIT increased just 3.7%. In recent years DKS invested approximately $100M (includes capital expenditures and incremental SG&A spend) in supply chain upgrades, digital marketing, IT and talent to improve its e-commerce offering and to ready the company to bring its e-commerce operations in-house in January 2017. The impact of these investments, coupled with the significant channel shift from brick and mortar to online resulted in a 150 bps decline in EBIT margin at DKS from 9.0% in FY2012 to 7.5% in FY2015.

While DKS does not disclose gross margins by channel, in a correspondence letter to the SEC in September 2014, the company noted that, "though the cost components for those two channels are slightly different…the gross profit rate shown in the company's income statement is indicative of the company's gross profit rate for all sales regardless of channel." While e-commerce and brick and mortar gross margin rates may be similar, our analysis of DKS cost structure indicates that the consolidated gross margin rate is under pressure from escalating shipping costs in the e-commerce channel and rising occupancy costs in the brick and mortar channel.

As shown in Table 3 below, while the cost of merchandise at DKS has remained relatively flat in recent years at just under 56% of total sales, escalating occupancy and shipping costs have contributed to a 150 bps decline in the gross margin rate at the company from 31.5% in FY2012 to 30.0% FY2015. We estimate shipping costs at DKS increased 120 bps from 9.0% of e-commerce sales in FY2012 to 10.2% in FY2015, suggesting the company is not benefitting from scale within its e-commerce business. We note that Amazon's shipping costs experienced a similar upward move in recent years, increasing from 9.3% of sales in 2013 to 11.6% of sales in 2015, suggesting DKS may find it difficult to leverage shipping costs, even as e-commerce sales become a larger percentage of the company's overall sales.

Table 3: COGS at DKS Broken Down by Line Item (FY2012-FY2015)

	FY 12	FY 13	FY 14	FY 15
Occupancy Costs	641,973	704,773	767,073	842,273
As a % of Total Revenues	11.00%	11.34%	11.26%	11.58%
As a % of B&M Revenues	11.61%	12.32%	12.40%	12.91%
Y/Y % Change	6.4%	9.8%	8.8%	9.8%
Shipping Costs	27,506	46,224	61,702	76,421
As a % of Ecommerce Revenues	9.00%	9.40%	9.80%	10.20%
As a % of Total Revenues	0.47%	0.74%	0.91%	1.05%
Y/Y % Change	63.9%	68.0%	33.5%	23.9%
Other Costs	78,500	82,600	100,200	113,500
As a % of Total Revenues	1.3%	1.3%	1.5%	1.6%
Y/Y % Change	13.4%	5.2%	21.3%	13.3%
Merchandise Costs	3,250,977	3,435,626	3,798,837	4,055,883
As a % of Total Revenues	55.7%	55.3%	55.7%	55.8%
Y/Y % Change		5.7%	10.6%	6.8%
One-time costs			2,400	-
Reported COGS	3,998,956	4,269,223	4,727,812	5,088,077
As a % of Total Revenues	68.5%	68.7%	69.4%	70.0%
Adjusted Gross Profit	1,837,163	1,943,950	2,089,067	2,182,888
Adj Gross Profit Margin %	31.5%	31.3%	30.7%	30.0%

Source: OWS estimates, company data, company transcripts

Similarly, we estimate occupancy costs as a percentage of brick and mortar sales at DKS increased approximately 130 bps from 11.6% in FY2012 to 12.9% in FY2015. On the F1Q15 conference call with investors, DKS' current CFO, Andre Hawaux, noted that the company requires ~10% total sales growth to leverage occupancy costs. Since SSS growth at DKS brick and mortar stores has been negative for several years, it appears the migration of customers on-line is resulting in a deleveraging of fixed costs at the company.

Furthermore, according to retail industry observers, e-commerce often facilitates comparison shopping and enables customers to benchmark product pricing. This impacts pricing power and often encourages companies like DKS to increase promotional activity, potentially pressuring margins and attracting more incentive-driven customers that only respond to discounts and promotions. In fact, in recent months, we have witnessed a steep acceleration in the frequency of in-store and online promotions from DKS, as measured by a dramatic increase in daily email spam, flash sales and "clearance sales." Given intensifying price competition and promotional activity, rising variable shipping costs, and ongoing fixed cost deleveraging, gross margin results at DKS in the year ahead may fall short of current bullish expectations.

In addition to the gross margin pressures outlined above, the channel shift to online may result in higher variable costs to support the e-commerce business. According to DKS management, bringing the e-commerce operations in-house will allow the company to leverage its e-commerce cost structure, resulting in annual SG&A savings of $25-$30M, and ~25 bps of upside to EBIT margin in FY2017 as compared to FY2016. While "street" models appear to reverse e-commerce spending trends in the years ahead and embed lower SG&A expenses in FY2017 and FY2018, running the e-commerce business internally may add an additional layer of risk for DKS and could cost more than "street" bulls currently anticipate, especially in year one (FY2017).

According to a report published by Credit Suisse in June 2016, in the past 10 years, as department stores grew their e-commerce business, mall anchor IT spend is estimated to have quadrupled from $300M, or 6% of overall capex in 2007 to $1.2B, or 35% of overall capex in 2016. According to Credit Suisse, because IT investments tend to have much shorter life spans than non-IT investments, IT systems must be upgraded continuously in order to keep up with technological advancements, secular growth in traffic online, and to ensure data and operational security.

As revenue mix at DKS shifts toward e-commerce (from ~10% currently to 15% or more by 2020), we expect e-commerce related SG&A, marketing and capex at DKS to grow in absolute dollar terms and as a percentage of sales. However, unlike the department store industry where the store base is shrinking, DKS expects to grow its physical store base by at least ~5% per year, suggesting capital intensity at DKS is set to increase as total capex spending accelerates in the years ahead.

In addition to higher variable costs related to ongoing technology investments, higher wages may offset much of DKS' cost savings initiatives. Our research suggests brick and mortar retailers like DKS face industry-wide wage increases triggered by Wal-Mart's February 2016 decision to increase its minimum wage to $13.38 for full-time hourly wage employees and to $10.58 for part-time hourly wage employees. We note that Kohl's and other department stores have announced that they are suffering from increased store expenses driven primarily by higher wages.

According to Glassdoor, the average wage range for a retail salesperson at DKS is $9.04-$9.23, well below the new wage level at Wal-Mart and below the average wage at other service oriented retailers like Cabela's at $10.13 and Bass Pro at $10.50. DKS initially claimed that it was not impacted by recent wage increases because its stores offered employees a "fun" place to work. At a recent Goldman Sachs investor conference in September however, DKS management appeared to change its stance on the subject. According to Andre Hawaux, DKS' CFO, "there's going to be wage inflation [and] we're going to have to figure our way out of it. I do believe for us, we'll see more of it in 2017."

The average salary at DKS may have to move higher to compete with Wal-Mart and other service oriented retailers. Furthermore, the Fair Labor Standards Act (FLSA) minimum salary requirements that go into effect December 1, 2016 may result in additional wage pressures at DKS in FY17. The new standards require overtime payment (over 40 hours per week) for salaried managers earning below $913/week or $47,500 per year versus the previous standard of $455/week or $23,600 per year. Since DKS management recently revised its point of view regarding the impact of wage inflation on the company at the Goldman conference in September, the wage inflation and/or the new FLSA standards are probably not factored into current consensus EBIT margin assumptions and earnings estimates.

Slowing in-store traffic and spend may force DKS to cut back its new store growth plans, close more stores, and/or invest in costly relocations to smaller store formats, resulting in slower square footage growth than bulls expect.
DKS already reduced the size of its store format from 70K square feet several years ago to 50K square feet. More recently, negative knock-on effects from increased online penetration in certain hardline categories like fitness equipment and golf forced DKS to reduce the amount of floor space dedicated to these categories. As e-commerce penetration increases in the years ahead, an even larger variety of sporting goods products should transition online, potentially accelerating negative knock-on effects, reducing in-store traffic and further lowering store productivity at DKS' brick and mortar stores.

We note that 25% of the Dick's Sporting Goods store base (~161 stores) and 50% of the Golf Galaxy store base (~36 stores) are up for lease renewal from 2016-2018, potentially providing DKS with a justification to close or relocate poorly performing stores to more relevant locations. Furthermore, the recently announced store closings by Macy's (~100 stores announced in August), Wal-Mart (~154 stores announced in January) and other department store mall anchor tenants may pressure DKS in-store traffic at certain locations, providing the company with additional incentive to close or relocate stores.

In fact, the pace of store closings at DKS accelerated from 3 in 2014 to 8 in 2015. In addition, over the last 2 years, DKS relocated 20 existing stores. Partly as a result of increased store relocations, pre-opening expenses as a percentage of total sales increased from 0.3% in 2013 to 0.5% in 2015. With sales per square foot at DKS' brick and mortar stores in decline, the pace of store closings and relocations at DKS could accelerate in the years ahead, potentially resulting in lower than expected net unit growth, higher SG&A and pre-opening expenses, and lower EBIT margins than bulls expect.

Finally, we note that DKS current guidance does not reflect any integration, rebranding and opening costs associated with the 31 stores the company has the right to acquire from TSA. While we do not expect DKS to acquire all 31 store leases, costs to rebrand and integrate additional TSA stores may partially offset anticipated cost savings in FY2017.

3. U.S. sporting goods sales now appear to be concentrated mainly among a group of large vendors and retailers. Therefore, the opportunity for DKS to take substantial market share may be smaller than expected.

According to the National Sporting Goods Association (NSGA), the U.S. sporting goods market generated sales of approximately $66.3B in 2015. According to DKS management, ~46% of the U.S. sporting goods industry is fragmented and made up of relatively small regional chains and local mom and pop retailers. DKS management believes the company will be a beneficiary of industry consolidation and expects the company's market share to increase from ~11% to the mid-to-high teens long term.

Our assessment of the U.S. sporting goods market is different. Indeed, it appears that the top 25 retailers make up more than 98% of total revenues in the U.S. sporting goods industry, suggesting the market is actually dominated by a select group of large retailers, vendors and e-commerce distributors.

Table 4 below shows a list of the top 25 retailers of sporting goods products in the U.S. by estimated sales. Our estimated sales and store count figures are based on data collected by SGB Weekly for its 2014 Retail Top 100 U.S. Sporting Goods Retailers publication, public company filings, company presentations and press reports.

Table 4: Top 25 Sporting Goods Retailers in the U.S. Based on Estimated Annual Sales

Rank	Retailer	Estimated Annual Sporting Goods Sales in the U.S. (in billions)	Estimated Market Share	Estimated # of Stores	Type of Retailer
1	WalMart	$9.6	14.5%	4,516	Mass Merchandiser
2	Dick's Sporting Goods	$7.2	10.9%	741	Sporting Goods Super Store
3	Foot Locker (includes Champs)	$5.3	8.0%	2,293	Specialty Retailer
4	Academy Sports & Outdoors	$4.6	6.9%	190	Sporting Goods Super Store
5	Target	$4.3	6.5%	1,790	Mass Merchandiser
6	Bass Pro Shops	$4.0	6.0%	91	Outdoor Recreational Retailer
7	Cabela's	$4.0	6.0%	74	Outdoor Recreational Retailer
8	Nike (DTC)	$3.0	4.5%	209	Vendor DTC
9	Amazon (includes Zappos.com)	$2.7	4.0%	0	Ecommerce
10	REI	$2.2	3.3%	138	Outdoor Recreational Retailer
11	Lululemon Athletica	$1.8	2.7%	302	Vendor DTC
12	Finish Line	$1.8	2.6%	1,032	Specialty Retailer
13	L.L. Bean	$1.6	2.4%	102	Outdoor Recreational Retailer
14	Kohl's	$1.5	2.3%	1,162	Department Store
15	TJX (includes Marmaxx & Sierra Tading Post)	$1.3	2.0%	2,100	Department Store
16	Gander Mountain	$1.3	2.0%	154	Outdoor Recreational Retailer
17	Costco	$1.2	1.9%	663	Warehouse Club
18	Under Armour	$1.2	1.8%	191	Vendor DTC
19	Journeys	$1.2	1.8%	1,182	Specialty Retailer
20	Big 5 Sporting Goods	$1.0	1.6%	439	Traditional Sporting Goods Store
21	Fanatics	$1.0	1.5%	0	Ecommerce
22	Macy's	$1.0	1.5%	823	Department Store
23	Hibbett Sports	$0.9	1.4%	988	Traditional Sporting Goods Store
24	Eddie Bauer	$0.9	1.4%	333	Specialty Retailer
25	Lids	$0.9	1.4%	1,164	Specialty Retailer
	Total	**$65.5**	**98.8%**	**20,677**	

Source: SGB Weekly, public company filings, press reports, OWS estimates

As Table 4 shows, the U.S. sporting goods industry appears to be more concentrated than DKS' management and bulls seem to believe. Accordingly, the opportunity for DKS to take market share may also be smaller than "street" analysts expect.

Importantly, many players on this list are relatively new to the top 25 ranking, including vendors like Nike and Under Armour, department stores like Kohl's and e-commerce channels like Amazon and Fanatics. Other e-commerce companies and vendor direct-to-consumer (DTC) businesses are growing rapidly as well, including Adidas, Reebok, The North Face, VF Corp (Lucy Activewear), Converse, Puma, New Balance and Backcountry.com.

4. Competition in certain high margin sports equipment categories and in the fast growing, high margin athletic apparel market (35% of DKS' sales) appears to be

intensifying. Price competition and increased promotional activity could pressure operating margins.

In addition to the large retailers and vendors in the top 25 ranking in Table 4 above, the recent proliferation of specialty sports retailers like Pure Hockey, ComLax, Monkey Sports, Sports Endeavors Inc. (soccer.com, etc.), and others may be an underestimated threat to sales of team sports equipment at DKS.
While DKS claims that the company offers consumers a wide selection of products and brands that enables it to address the needs of consumers, from the beginner to the sports enthusiast, our store checks suggest that DKS product offerings in most team sports categories cater mostly to a mass market audience. Our research suggests that the lack of premium product offerings at DKS, limited year-round selection and inadequate sport-specific expertise may be alienating high spending, premium customers.

According to specialty sports equipment retailers with whom we have spoken, the privatization of youth sports and the rapid growth of club teams for lacrosse, hockey, soccer and other sports in the U.S. has given rise to sports equipment retailers and e-commerce channels that specialize in a single sport and that appeal to a growing number of high spending consumers that require year-round access to high quality, sport-specific equipment, merchandise and expertise.

For example, TSG Enterprises, LLC was founded in 2002 in Massachusetts through the purchase of a single specialty sports store dedicated to hockey. Since 2002, TSG expanded organically and through acquisitions and now operates 54 retail stores in major hockey and lacrosse markets across the U.S. including MA, CT, NJ, NY, CO, MD and CA and as well as 7 e-commerce websites focused on hockey, lacrosse and goalie equipment. The company sells specialty sports equipment products under several e-commerce and retail banners, including Pure Hockey, Hockey Giant, Pure Goalie, Total Hockey and Commonwealth Lacrosse (ComLax).

In 2014, TSG Enterprises cracked the Top 100 for U.S. Sporting Goods Retailers as ranked by SGB Weekly, coming in at #98. With its recent acquisition of Total Hockey in August, 2016, we estimate the company will generate pro-forma sales of ~$133M in 2016, putting it just behind Eastern Mountain Sports (EMS) on SGB Weekly's list of Top 100 Sporting Goods Retailers.

While TSG believes it is the largest multichannel hockey and lacrosse retailer in the U.S., the company thinks its most significant competitive advantage relative to DKS and other general sporting goods stores is its ability to better service the single sport, club youth athlete. According to one store manager with whom we spoke, "club sports athletes today are playing and practicing year round, traveling to and participating in 10-20 or more "offseason" tournaments per year, in addition to playing a normal seasonal schedule. These athletes want year-round access to top quality equipment, advice and service that only a dedicated shop like ours can provide."

At ComLax, for example, every store manager is a former or current lacrosse player with first hand knowledge about pocket stringing and proper pad and helmet fitting, and is fully educated about the latest lacrosse products from STX, Brine, Maverik, Gait and many more brands not found at DKS. Importantly, several ComLax customers told us that they used to shop at general sporting goods stores like DKS when they first started playing sports. Now that these athletes specialize in a single sport however, they tend to play with higher end equipment and shop almost exclusively at a ComLax store or at one of the leading lacrosse e-commerce websites such as Universal Lacrosse, Lacrosse Unlimited or LacrosseMonkey.

In addition to a larger in-store selection of top lacrosse brands and more knowledgeable staff people, specialty equipment retailers like ComLax and many other specialty retailers partner with various youth club teams throughout the country to supply their programs with equipment, uniforms and footwear, creating greater consumer awareness of and strengthening customer loyalty for these retail brands.

In June 2010, Ed Stack, DKS CEO, acknowledged the importance of the lacrosse business to the company:

> "The lacrosse business is something that's just been on fire, we have gotten out ahead of this, we've always been in the lacrosse business and we've had a great presence of lacrosse kind of in the original hot beds of lacrosse, which was kind of the – from Boston to D.C. and a little bit down into the Carolina's. Now that lacrosse is really moving across the country both boys and girls, we're really very excited about it. And especially on the boys side because you can build a great sale of lacrosse product and run a pretty good size ticket in lacrosse by the time you get the helmet, you get the stick, which the kids are all buying components now, not many of them are buying premade sticks, they want their own shaft mixed the head and string the head themselves and then along with the helmet with the gloves, the shoulder pads, you build a really nice ticket with the lacrosse business."

The migration of dedicated, single sport athletes away from DKS to specialty sport retailers, like ComLax and others, suggests the company may be losing the battle for high spending, premium customers, especially in high margin, equipment heavy sports like lacrosse and hockey. As a general "all-in-one" sporting goods store that caters to a broad consumer base, and operates a seasonal merchandising strategy for much of its sporting equipment, DKS seems ill prepared to meet the rising demands of the "pay-to-play" consumer, potentially resulting in reduced customer loyalty, lower in-store traffic and lower sales of high margin sports equipment than "street" bulls expect.

In addition to emerging competition from specialty sports retailers, the athletic apparel market is undergoing a meaningful transition, with many new retailers and vendors entering the market to participate in the "athleisure" growth trend. In fact, today there are more active wear product choices available to the consumer from a larger variety of vendors and retailers than ever before.

Maturing growth in the "athleisure" trend, coupled with the proliferation of vendors and retail channels, suggests the active wear market may be nearing saturation. As a result, competition in the athletic apparel market (35% of total sales at DKS) is also intensifying. Since DKS does not sell exclusive merchandise from Nike, Under Armour or any other major vendors, DKS appears to have little, if any, merchandise scarcity, making the company vulnerable to price battles and a constant cycle of increased promotional activity and higher marketing spend, potentially pressuring margins.

In recent years, many retailers launched their own private label active wear brands and are devoting more floor space to the active wear apparel category. More recently, department stores like Kohl's and off-price retailers like DSW and H&M entered the category to compete against more traditional athletic apparel retailers like DKS, potentially setting the stage for more widespread pricing pressure for sports apparel sold at DKS.

For example, since 2014, Kohl's has made a sizeable investment in its "active and wellness" category, enhancing and expanding key national and private brands and providing customers with an expanded assortment of active wear apparel and shoes. In fact, store managers report that the store space dedicated to active wear has doubled over the last year.

More recently, Kohl's announced plans to sell Under Armour products at its stores beginning Spring 2017. We estimate active wear sales at Kohl's were approximately $3B in 2015, or ~15% of total company sales. "Street" analysts estimate that sales of Under Armour apparel at Kohl's could approach $200M-$300M once the supply chain is fully developed. By comparison, "street" analysts estimate sales of Nike products at Kohl's grew low double digits in 2015 to ~$800M-$1B.

While DKS management told investors on the 2Q16 conference call in August that the Under Armour assortment at Kohl's will be different than at DKS, Under Armour contradicted this statement, saying the company would supply Kohl's with the same merchandise it sells elsewhere. We note that DKS management did acknowledge that Under Armour's expansion into Kohl's was "not a positive" for the company.

Note that in 2015 Under Armour accounted for 12% of DKS' purchased merchandise. Assuming a 44% gross margin percentage, sales of Under Armour products at DKS may be ~$677M, or approximately 9.3% of DKS' total sales. Given the significance of the Under Armour brand at DKS, and Kohl's recent success with Nike in the athletic apparel category, DKS may experience share loss to Kohl's in the years ahead, potentially offsetting some the shares gains from TSA.

While "street" bulls believe the recent bankruptcies of sporting goods retailers will benefit DKS as DKS becomes increasingly important to its vendors, the evidence suggests DKS is becoming a smaller distribution channel for certain key, fast growing vendors like Under Armour. In the past, wholesalers like DKS were the primary point of distribution for sporting goods vendors. In recent years however, the sporting goods industry has experienced a dramatic shift in the way sporting goods equipment, footwear and apparel products are sold and purchased. For example, sporting goods vendors like Nike and Under Armour, which accounted for ~32% of DKS merchandise purchases in FY2015, have increased their distribution points, selling product through their own branded retail stores and websites and through a growing variety of brick and mortar retail channels, including departments stores, sporting goods stores and specialty retailers.

In fact, as shown in Table 5 below, we estimate that DKS is becoming a smaller percentage of Under Armour's North American sales. Specifically, we estimate that DKS share of Under Armour's North American sales fell from 17.2% in 2013 to 13.6% in 2015. Even if Under Armour sales growth to DKS stays constant at ~3.5% Y/Y, in-line with 2015 results, DKS market share with Under Armour could fall to 10.6% by 2017.

Table 5: DKS as a % of Under Armour's North American Sales (2012-2017e)

(In $millions)	2012	2013	2014	2015	2016e	2017e
UA as a % of DKS merchandise purchases	<10%	11%	12%	12%	11%	11%
Under Armour sales to DKS		378	456	470	487	504
Y/Y % Change			20.6%	3.2%	3.5%	3.5%
UA N. American sales	1,727	2,194	2,796	3,456	4,057	4,763
Y/Y % Change		27.0%	27.5%	23.6%	17.4%	17.4%
DKS as a % of UA's N. American sales		17.2%	16.3%	13.6%	12.0%	10.6%

Source: DKS SEC documents, UA SEC documents, OWS estimates

Importantly, increasing the amount of goods sold direct to consumers (DTC) through both owned stores and online allows vendors to capture a larger percentage of merchandise profits. Accordingly, it is not surprising that at its Analyst Day in October 2015 Nike, DKS largest vendor at 20% of merchandise purchased in 2015, announced its intention to grow its global DTC sales from $6.6B in 2015 to $16B by 2020.

Given DKS' heavy exposure to Nike branded products (20% of merchandise purchased in 2015), we think Nike's North American DTC channel represents a growing threat to DKS market share in the U.S. sporting goods market. We estimate that Nike's North American DTC sales will increase from ~$3B in 2015 (~21% of Nike's North American sales) to ~$6.4B in 2020 (~32% of Nike's North American sales), potentially making Nike's DTC business the 3rd largest retailer of sporting goods in the U.S., behind DKS and Wal-Mart. We note that other major suppliers to DKS, including Under Armour (12% of DKS purchased merchandise in 2015) and Columbia Sportswear have similar plans to grow their DTC distribution channels in the years ahead.

This channel shift could have long-term negative implications for general sporting goods retailers like DKS that rely on branded products to drive traffic to their stores. In order for DKS to grow its market share position as bulls expect, the company may have to diversify the brands it carries, invest more to grow its private label brands, and gain access to more exclusive brands and products that aren't widely available through other distribution channels, potentially increasing fashion risk and resulting in more volatile traffic trends.

Bulls appear to be aware of the secular threat from vendor disintermediation and point to DKS success in developing its private label brands (CALIA, Field & Stream, etc.) as evidence that the company will be able to defend its market share position against its own suppliers and drive in-store traffic and merchandise margins with sales of its own exclusive brands.

For its part, DKS management claims sales of private label products have been ~10% of total sales over the last 3 years. The company expects to grow its private label sales to $1B by 2020. Despite the company's optimistic growth target, recent correspondence documents with the SEC suggest DKS private label sales grew at a CAGR of just 4% from 2013 to 2015 to $793M, and shrunk as a percentage of total sales from 11.8% in 2013 to 10.9% in 2015. Given the recent modest sales growth of DKS private label brands as compared to branded products, we are skeptical that private label sales will be a significant driver of traffic growth or a meaningful contributor to higher merchandise margins, as bulls expect.

5. Recent Results

On August 12th, 5 days before the company's scheduled F2Q16 earnings release, DKS issued a press release announcing that Teri List-Stoll was no longer EVP and CFO of DKS. Importantly, the company provided no explanation for the sudden departure of the CFO. While Teri List-Stoll had been named DKS' CFO only a year earlier, investors might be concerned by the lack of disclosure and transparency regarding the departure of a key member of the executive management team.

On August 16, DKS reported F2Q16 earnings results that exceeded consensus expectations and management's previous guidance. DKS reported F2Q16 EPS of $0.82 versus $0.77 a year ago, ahead of the consensus estimate of $0.69 and above the high end of the $0.62-$0.72 guidance range. Consolidated SSS growth of +2.8% exceeded consensus of -2.4%, driven by market share gains following the earlier than expected closure of TSA stores in July.

F2Q16 results were aided by the licensed apparel business, which benefitted from the Cleveland Cavaliers NBA Championship and the Pittsburgh Penguins Stanley Cup win in June 2016. We estimate DKS operates approximately 50 stores in OH and 52 stores in PA, representing ~14% of DKS' total store base. While management described the impact of these events as a "meaningful" contributor to SSS growth in the quarter, we estimate this could have added 100 bps to SSS growth. Given DKS' significant exposure to these states and the one-time nature of these events, we do not expect a similar sales growth contribution from the company's licensed apparel business in FY2017.

6. Financial Assumptions

a.) Revenue assumptions

On a consolidated basis, we expect revenue of $7,821M in FY2016 and $8,315M in FY2017. "Street" consensus estimates call for revenue of $7,833M in FY2016 and $8,551M in FY2017.

On a gross basis, we assume DKS opens 47 new stores in FY2016 and 62 new stores in FY2017, including 15 incremental new stores acquired from TSA. We think the combination of weak in-store traffic at brick and mortar stores and the closure of anchor department stores such as Macy's should result in accelerated store relocations and closures at DKS, as compared to previous years. Furthermore, with 25% of Dick's Sporting Goods store base (~161 stores) and 50% of Golf Galaxy's store base (~36 stores) up for renewal over the next 3 years from 2016-2018, we expect a steady increase in closures and relocations over the next several years.

Specifically, we assume DKS closes 8 stores in FY2016 and 15 in FY2017, as lease terms expire and are not renewed. We note that 23 total store closures represents about 12% of the ~197 stores up for lease renewal from 2016-2018. On a net basis, we assume DKS opens 39 new stores in FY2016 and 47 stores in FY2017, as compared to consensus estimates of 43 stores in FY2016 and 55 stores in FY2017. We assume 9 store relocations in FY2016 and 15 in FY2017. We note that if we assume 1/3rd are closed, 1/3rd are relocated and 1/3rd are renegotiated, that would imply approximately 22 closings and 22 relocations per year, on average. Our estimates assume a slightly lower rate of relocations and closures.

We assume consolidated SSS growth of 2.7% in FY2016 and 1.4% in FY2017, as compared to "street" estimates of 2.7% and 3.4%, respectively. Our consolidated SSS growth estimate of 2.7% in FY2016 is driven by our forecast of a 21.8% increase in e-commerce sales and a 0.5% increase in brick and mortar SSS. Our consolidated SSS growth estimate of 1.4% in FY2017 is driven by a 13.9% increase in e-commerce sales and a -0.3% decrease in brick and mortar SSS. We assume DKS' brick and mortar SSS growth turns negative in F2Q17, as DKS comps against the TSA bankruptcy, the Cleveland Cavaliers and Pittsburgh Penguins championships, and the lead up to the Rio Olympics.

b.) Gross margin assumptions

Table 6 shows DKS' historical gross margin performance and our estimates for the next 2 years. We expect gross margin to improve by 15 bps Y/Y in FY2016, due to leveraging of occupancy costs and relatively flat merchandise costs, partially offset by higher shipping costs. In FY2017 we expect gross margin to decline by 36 bps due to intensifying price competition in athletic apparel, deleveraging of occupancy costs, and increased shipping costs. By comparison, consensus estimates assume a gross margin rate of 30.3% in FY2016 and 30.5% in FY2017.

Table 6: DKS Historical and Estimated Gross Margin

	FY2013	FY2014	FY2015	FY2016e	FY2017e
Gross margin	31.3%	30.7%	30.0%	30.2%	29.8%
Y/Y change	(19)	(63)	(63)	15	(36)

Source: OWS estimates, company reports

c.) SG&A & pre-opening expense assumptions

Table 7 shows DKS' historical SG&A and pre-opening expense as a percentage of sales and our estimates for the next two years. We assume SG&A as a percentage of sales increases by 65 bps in FY2016 driven by higher expenses associated with the integration of TSA stores, investments in e-commerce and Olympic-related marketing costs. In FY2017, we assume SG&A expenses decline 40 bps Y/Y, driven by savings from bringing e-commerce in-house and a reduction in "one-time" expenses associated with footwear decks, the Olympics and e-commerce. In FY2017 we assume there will be ongoing expenses associated with the integration of TSA and e-commerce enhancements as well as modest wage pressure.

We assume pre-opening expenses increase starting in 3Q16 through 2017, as DKS relocates additional stores as leases come due. Furthermore, we expect pre-opening expenses to increase as DKS retrofits acquired TSA stores in 2H16 and 2017.

Table 7: DKS Historical and Estimated SG&A Expense as a % of Sales

	FY2013	FY2014	FY2015	FY2016e	FY2017e
SG&A % of sales	22.2%	22.0%	22.1%	22.7%	22.3%
Y/Y change	(5)	(20)	9	65	(40)
Pre-opening % of sales	0.3%	0.4%	0.5%	0.5%	0.6%
Y/Y change	6	11	3	3	6

Source: OWS estimates, company reports

d.) Other items

We assume net interest expense of $752K in FY2016 and $4M in FY2017, in-line with "street" assumptions. We forecast a tax rate of 38.3% in FY2016 and 38.5% in FY2017, in-line with "street" assumptions. Our share count assumptions are 111.8M in FY2016 and 108.0M in FY2017. These assumptions are also in-line with those of the "street." Finally, we expect EPS of $3.01 in FY2016 and $3.26 in FY2017 versus the "street's forecast of $3.05 and $3.71, respectively.

7. Valuation

At $59.13, DKS shares currently trade at 15.9X the FY2017 consensus estimate of $3.71, a 10% premium to its historical mean PE multiple of 14.5X and a 49% premium to a peer group of secularly challenged specialty retailers and department store chains (see Table 7).

We expect investors to rerate DKS earning multiple, as the proliferation of alternative channels of distribution from vendors, emerging specialty retailers and off-price wholesalers, and the migration of consumers online results in lower in-store traffic, escalating variable costs (shipping, marketing, e-commerce investments), deleveraging of fixed costs and eventually lower unit growth and increased store closures. Our target of $39.00 is approximately 12.0X our FY2017 EPS estimate of $3.26, a slight premium to the secularly challenged peer group average PE multiple of 10.7X.

Table 7: DKS PE Multiple vs. Secularly Challenged Specialty Retail & Dept Store Peers

Company	Ticker	Market Cap (USD, millions)	PE CY 2017
Best Buy	BBY	$11,919	12.6
Bed Bath & Beyond	BBBY	$6,512	8.9
Pier 1 Imports	PIR	$384	10.5
Staples	SPLS	$5,417	9.4
Kohl's	KSS	$7,573	10.9
JC Penney	JCP	$2,902	12.2
Macy's	M	$11,160	10.9
Dillard's	DDS	$2,110	9.9
Peer Group Average			10.7
Dick's Sporting Goods	DKS	$6,614	15.9

Source: Bloomberg, OWS estimates

8. Risks

The primary risk to our thesis is that potential market share gains from TSA's bankruptcy or other competitor bankruptcies may prove larger and more sustainable than we expect. Based on our analysis of the U.S. sporting goods market, we think any future bankruptcies by regional players in the sporting goods market are likely to be significantly smaller than TSA, and therefore are not likely to be a meaningful contributor to sales growth and market share gains for DKS.

With little debt on the balance sheet, DKS could tap the debt market to make a transformative acquisition that could change the competitive position of the company in the sporting goods market. We note that some analysts have speculated that DKS could purchase Cabela's to enhance its position in the outdoor sporting goods market.

Finally, DKS may be able to secure exclusive product from an existing or new vendor that could provide the company with "product scarcity." The introduction of exclusive product could serve as a catalyst to drive customer traffic to DKS stores, potentially reversing recent weak traffic trends and negative SSS growth at DKS brick and mortar stores.

9. Quarterly Income Statement

Qtrly Inc Statement	2Q16a	3Q16e	4Q16e	1Q17e	2Q17e
Ecommerce Sales	167.3	170.8	422.0	183.3	192.4
B&M Sales	1,800.6	1,590.7	2,009.0	1,600.6	1,909.8
Total Revenue	1,967.9	1,761.5	2,431.0	1,783.9	2,102.2
COGS	1,370.5	1,240.1	1,685.7	1,252.7	1,469.8
Gross Profit	597.4	521.4	745.3	531.2	632.4
SG&A	441.7	428.3	508.0	421.1	463.5
Pre-Opening	8.5	19.2	5.5	8.8	11.2
Total Oper Costs	1,820.7	1,687.6	2,199.2	1,682.6	1,944.4
EBIT	147.2	73.8	231.8	101.3	157.8
Interest Expense	1.6	2.0	2.0	2.0	2.0
Other	(1.9)	(1.0)	(1.0)	(1.0)	(1.0)
Pretax Income	147.5	72.8	230.8	100.3	156.8
Inc Taxes	56.1	28.0	88.9	38.6	60.4
Net Income	91.4	44.8	142.0	61.7	96.4
EPS	$0.82	$0.40	$1.29	$0.56	$0.89
F.D. Shares	112.1	111.3	110.4	109.6	108.7

Y/Y % Change	2Q16a	3Q16e	4Q16e	1Q17e	2Q17e
Ecommerce Sales	25.7%	30.0%	20.0%	20.0%	15.0%
B&M Sales	6.5%	5.3%	6.4%	6.2%	6.1%
SSS	2.8%	3.0%	4.0%	3.0%	2.0%
EBIT	-0.8%	-13.1%	11.6%	11.7%	7.2%
Pretax Income	0.0%	-2.6%	12.5%	9.5%	6.3%
Net Income	0.6%	-5.1%	10.0%	8.5%	5.5%
Adj EPS	5.7%	-0.7%	13.6%	12.1%	8.8%
F.D. Shares	-4.8%	-4.5%	-3.1%	-3.3%	-3.0%

As a % of Sales	2Q16a	3Q16e	4Q16e	1Q17e	2Q17e
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Total Operating Costs	92.5%	95.8%	90.5%	94.3%	92.5%
EBIT	7.5%	4.2%	9.5%	5.7%	7.5%
Pretax Income	7.5%	4.1%	9.5%	5.6%	7.5%
Tax Rate	38.0%	38.5%	38.5%	38.5%	38.5%
Net Income	4.6%	2.5%	5.8%	3.5%	4.6%

10. Annual Income Statement

Annual Inc Statement	2013	2014	2015	2016e	2017e
Ecommerce Sales	491.7	629.6	749.2	912.9	1,039.7
B&M Sales	5,721.4	6,184.9	6,521.7	6,907.8	7,275.1
Total Revenue	6,213.2	6,814.5	7,271.0	7,820.7	8,314.7
COGS	4,269.2	4,725.4	5,088.1	5,460.8	5,835.8
Gross Profit	1,944.0	2,089.1	2,182.9	2,359.9	2,479.0
SG&A	1,378.4	1,498.5	1,605.2	1,776.6	1,856.3
Pre-Opening	20.8	30.5	34.6	39.7	47.3
Total Oper Costs	5,668.5	6,254.4	6,727.9	7,277.2	7,739.3
EBIT	544.7	560.1	543.1	543.5	575.4
Interest Expense	2.9	3.2	4.0	6.7	8.0
Other	(7.9)	(5.2)	0.3	(6.0)	(4.0)
Pretax Income	546.1	556.0	530.9	542.8	571.4
Inc Taxes	208.5	211.8	200.5	207.7	220.0
Net Income	337.6	344.2	330.4	335.0	351.4
EPS	$2.69	$2.84	$2.83	$3.01	$3.26
F.D. Shares	125.6	121.2	116.8	111.8	108.0

Y/Y % Change	2013	2014	2015	2016e	2017e
Ecommerce Sales	56.6%	60.9%	28.0%	19.0%	21.8%
B&M Sales	3.5%	8.1%	5.4%	5.9%	5.3%
SSS	1.9%	2.4%	-0.2%	2.7%	1.4%
EBIT	4.0%	2.8%	-3.0%	0.1%	5.9%
Pretax Income	11.5%	1.8%	-4.5%	2.2%	5.3%
Net Income	16.1%	2.0%	-4.0%	1.4%	4.9%
Adj EPS	16.4%	5.6%	-0.4%	6.3%	8.6%
F.D. Shares	-0.3%	-3.5%	-3.7%	-4.3%	-3.3%

As a % of Sales	2013	2014	2015	2016e	2017e
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Total Operating Costs	91.2%	91.8%	92.5%	93.0%	93.1%
EBIT	8.8%	8.2%	7.5%	7.0%	6.9%
Pretax Income	8.8%	8.2%	7.3%	6.9%	6.9%
Tax Rate	38.2%	38.1%	37.8%	38.3%	38.5%
Net Income	5.4%	5.1%	4.5%	4.3%	4.2%

11. Cash Flow & Other Data

Debt & Operating Leases	3,390
Equity	1,830
Tangible book	$13.37
Market value	6,630
Cash	112
EV	9,907

	2013	2014	2015	2016e	2017e
Operating cash flow	356.1	504.3	477.9	541.3	584.5
Gross Capex	(285.7)	(349.0)	(370.0)	(443.1)	(415.0)
Proceeds from Sale of Other Assets	11.0	74.5			
Deferred Construction Allowances	47.8	101.6	165.6	175.0	161.9
Free cash flow	129.2	331.5	273.5	273.3	331.3
Dividends	(64.4)	(61.3)	(64.7)	(67.8)	(71.1)
CF After Divs	64.8	270.3	208.8	205.4	260.3
Acquisitions, net				(24.9)	0.0
Net Debt Issuance (Reduction)	34.5	(30.2)	28.6	0.0	0.0
Net Share Issuance/(Buyback)	(185.0)	(161.7)	(329.8)	(181.6)	(172.6)
CF after all	(85.7)	78.4	(92.5)	(1.0)	87.7
EV/EBITDA	14.3	13.5	13.6	13.1	12.1
EV/FCF	76.7	29.9	36.2	36.3	29.9
EV/Sales	2.3	2.1	1.9	1.8	1.7
FCF per Share	$1.03	$2.73	$2.34	$2.44	$3.07