

DSW Inc.  
Form 10-Q  
September 03, 2009

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended August 1, 2009**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 1-32545**

**DSW INC.**

(Exact name of registrant as specified in its charter)

Ohio

31-0746639

(State or other jurisdiction of  
Incorporation or organization)

(I.R.S. Employer Identification No.)

810 DSW Drive, Columbus, Ohio

43219

(Address of principal executive offices)

(Zip Code)

(614) 237-7100

Registrant's telephone number, including area code

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☐ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

Edgar Filing: DSW Inc. - Form 10-Q

The number of outstanding Class A Common Shares, without par value, as of August 28, 2009 was 16,430,700 and Class B Common Shares, without par value, as of August 28, 2009 was 27,702,667.

---

**DSW INC.  
TABLE OF CONTENTS**

| <b>Item No.</b>   | <b>Page</b> |
|---|-------------|
| <br><u>Part I. Financial Information</u>  |             |
| <br><u>Item 1. Financial Statements</u>   |             |
| <u>Condensed Consolidated Balance Sheets at August 1, 2009 and January 31, 2009</u>   | 2           |
| <u>Condensed Consolidated Statements of Income for the three and six months ended August 1, 2009 and August 2, 2008</u>     | 3           |
| <u>Condensed Consolidated Statements of Shareholders' Equity for the six months ended August 1, 2009 and August 2, 2008</u> | 4           |
| <u>Condensed Consolidated Statements of Cash Flows for the six months ended August 1, 2009 and August 2, 2008</u>           | 5           |
| <u>Notes to the Condensed Consolidated Financial Statements</u>   | 6           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 15          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | 22          |
| <u>Item 4. Controls and Procedures</u>  | 22          |
| <br><u>Part II. Other Information</u>   |             |
| <u>Item 1. Legal Proceedings</u>  | 23          |
| <u>Item 1A. Risk Factors</u>  | 23          |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 23          |
| <u>Item 3. Defaults Upon Senior Securities</u>  | 24          |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u>  | 24          |
| <u>Item 5. Other Information</u>  | 24          |
| <u>Item 6. Exhibits</u>   | 24          |
| <u>Signature</u>  | 25          |
| <u>Index to Exhibits</u>  | 26          |
| <u>Exhibit 31.1</u>   |             |

Exhibit 31.2

Exhibit 32.1

Exhibit 32.2

**Table of Contents****Part I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**DSW INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share amounts)  
(unaudited)

|   | <b>August 1,<br/>2009</b> | <b>January 31,<br/>2009</b> |
|---|---------------------------|-----------------------------|
| <b>ASSETS</b>   |                           |                             |
| Cash and equivalents  | \$ 39,279                 | \$ 54,782                   |
| Short-term investments, net   | 139,687                   | 101,404                     |
| Accounts receivable, net  | 5,706                     | 6,851                       |
| Accounts receivable from related parties, net   | 187                       | 336                         |
| Inventories   | 264,295                   | 244,008                     |
| Prepaid expenses and other current assets   | 21,404                    | 24,790                      |
| Deferred income taxes   | 26,095                    | 21,876                      |
| <br>Total current assets  | <br>496,653               | <br>454,047                 |
| <br>Property and equipment, net   | <br>220,573               | <br>233,366                 |
| Goodwill  | 25,899                    | 25,899                      |
| Tradenames and other intangibles, net   | 3,241                     | 3,668                       |
| Deferred income taxes and other assets  | 2,150                     | 4,217                       |
| <br>Total assets  | <br>\$ 748,516            | <br>\$ 721,197              |
| <br><b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                           |                             |
| Accounts payable  | \$ 99,903                 | \$ 92,912                   |
| Accounts payable to related parties   | 2,250                     | 2,299                       |
| Accrued expenses:   |                           |                             |
| Compensation  | 8,448                     | 9,971                       |
| Taxes   | 17,545                    | 10,228                      |
| Gift cards and merchandise credits  | 13,976                    | 15,491                      |
| Other   | 25,763                    | 27,425                      |
| <br>Total current liabilities   | <br>167,885               | <br>158,326                 |
| <br>Deferred income taxes and other non-current liabilities   | <br>97,099                | <br>97,287                  |
| <br><b>Shareholders equity:</b>   |                           |                             |
| Class A Common Shares, no par value; 170,000,000 authorized; 16,415,100 and 16,315,746 issued and outstanding, respectively | 297,532                   | 294,222                     |
| Class B Common Shares, no par value; 100,000,000 authorized; 27,702,667 and 27,702,667 issued and outstanding, respectively |                           |                             |

Edgar Filing: DSW Inc. - Form 10-Q

Preferred Shares, no par value; 100,000,000 authorized; no shares issued or outstanding

|  |            |            |
|--|------------|------------|
| Retained earnings                          | 186,729    | 172,017    |
| Accumulated other comprehensive loss       | (729)      | (655)      |
| Total shareholders' equity                 | 483,532    | 465,584    |
| Total liabilities and shareholders' equity | \$ 748,516 | \$ 721,197 |

The accompanying Notes are an integral part of the Condensed Consolidated Financial Statements.

Table of Contents

**DSW INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands, except per share amounts)  
(unaudited)

|  | <b>Three months ended</b> |                           | <b>Six months ended</b>   |                           |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
|  | <b>August 1,<br/>2009</b> | <b>August 2,<br/>2008</b> | <b>August 1,<br/>2009</b> | <b>August 2,<br/>2008</b> |
| Net sales                              | \$ 369,490                | \$ 357,175                | \$ 755,336                | \$ 723,439                |
| Cost of sales                          | (271,702)                 | (256,081)                 | (552,567)                 | (525,298)                 |
| Gross profit                           | 97,788                    | 101,094                   | 202,769                   | 198,141                   |
| Operating expenses                     | (86,427)                  | (83,415)                  | (179,305)                 | (164,456)                 |
| Operating profit                       | 11,361                    | 17,679                    | 23,464                    | 33,685                    |
| Interest expense                       | (188)                     | (304)                     | (371)                     | (578)                     |
| Interest income                        | 766                       | 724                       | 1,203                     | 1,721                     |
| Interest income, net                   | 578                       | 420                       | 832                       | 1,143                     |
| Non-operating income, net              | 528                       |                           | 133                       |                           |
| Earnings before income taxes           | 12,467                    | 18,099                    | 24,429                    | 34,828                    |
| Income tax provision                   | (4,900)                   | (7,142)                   | (9,717)                   | (13,583)                  |
| Net income                             | \$ 7,567                  | \$ 10,957                 | \$ 14,712                 | \$ 21,245                 |
| Basic and diluted earnings per share   | \$ 0.17                   | \$ 0.25                   | \$ 0.33                   | \$ 0.48                   |
| Shares used in per share calculations: |                           |                           |                           |                           |
| Basic                                  | 44,074                    | 43,999                    | 44,046                    | 43,983                    |
| Diluted                                | 44,420                    | 44,242                    | 44,355                    | 44,195                    |

The accompanying Notes are an integral part of the Condensed Consolidated Financial Statements.



Table of Contents

**DSW INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(in thousands)  
(unaudited)

|   | Number of     |               | Class         |               | Accumulated       |                          |               |
|---|---------------|---------------|---------------|---------------|-------------------|--------------------------|---------------|
|   | Class A       | Class B       | Class A       | Class B       | Retained Earnings | Other Comprehensive Loss | Total         |
|   | Common Shares | Common Shares | Common Shares | Common Shares |                   |                          |               |
| <b>Balance, February 2, 2008</b>  | 16,264        | 27,703        | \$ 288,365    | \$ 0          | \$ 145,115        | \$ 0                     | \$ 433,480    |
| Net income  |               |               |               |               | 21,245            |                          | 21,245        |
| Unrealized loss on available-for-sale securities, net of tax benefit of \$115 |               |               |               |               |                   | (175)                    | (175)         |
| <i>Total comprehensive income</i>   |               |               |               |               |                   |                          | <i>21,070</i> |
| Stock units granted   | 41            |               | 557           |               |                   |                          | 557           |
| Tax shortfall related to restricted stock unit exercises                      |               |               | (23)          |               |                   |                          | (23)          |
| Exercise of restricted stock units, net of settlement of taxes                | 2             |               | (13)          |               |                   |                          | (13)          |
| Stock based compensation expense, before related tax effects                  |               |               | 2,012         |               |                   |                          | 2,012         |
| <b>Balance, August 2, 2008</b>  | 16,307        | 27,703        | \$ 290,898    | \$ 0          | \$ 166,360        | \$ (175)                 | \$ 457,083    |
| <b>Balance, January 31, 2009</b>  | 16,316        | 27,703        | \$ 294,222    | \$ 0          | \$ 172,017        | \$ (655)                 | \$ 465,584    |
| Net income  |               |               |               |               | 14,712            |                          | 14,712        |
| Unrealized loss on available-for-sale securities                              |               |               |               |               |                   | (74)                     | (74)          |
| <i>Total comprehensive income</i>   |               |               |               |               |                   |                          | <i>14,638</i> |
| Stock units granted   | 45            |               | 570           |               |                   |                          | 570           |
| Exercise of restricted stock units, net of settlement of taxes                | 54            |               | (177)         |               |                   |                          | (177)         |
| Stock based compensation expense, before related tax effects                  |               |               | 2,917         |               |                   |                          | 2,917         |
| <b>Balance, August 1, 2009</b>  | 16,415        | 27,703        | \$ 297,532    | \$ 0          | \$ 186,729        | \$ (729)                 | \$ 483,532    |

The accompanying Notes are an integral part of the Condensed Consolidated Financial Statements.

**Table of Contents**

**DSW INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited)

|   | <b>Six months ended</b>   |                           |
|---|---------------------------|---------------------------|
|   | <b>August 1,<br/>2009</b> | <b>August 2,<br/>2008</b> |
| Cash flows from operating activities:   |                           |                           |
| Net income  | \$ 14,712                 | \$ 21,245                 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |                           |
| Depreciation and amortization   | 22,724                    | 15,711                    |
| Amortization of debt issuance costs   | 59                        | 59                        |
| Stock based compensation expense  | 2,917                     | 2,012                     |
| Deferred income taxes   | (3,437)                   | 2,141                     |
| Loss on disposal of long-lived assets   | 156                       | 125                       |
| Impairment charges on long-lived assets   | 1,645                     | 730                       |
| Non-operating income  | (133)                     |                           |
| Grants of stock units   | 570                       | 557                       |
| Other   | (2,031)                   | (6,516)                   |
| Change in working capital, assets and liabilities:                                |                           |                           |
| Accounts receivable, net  | (1,770)                   | 2,462                     |
| Inventories   | (20,287)                  | (24,832)                  |
| Prepaid expenses and other current assets   | 3,386                     | (1,993)                   |
| Accounts payable  | 8,600                     | 13,162                    |
| Proceeds from construction and tenant allowances                                  | 4,867                     | 10,416                    |
| Accrued expenses  | 4,450                     | 2,239                     |
| Net cash provided by operating activities   | \$ 36,428                 | \$ 37,518                 |
| Cash flows from investing activities:   |                           |                           |
| Cash paid for property and equipment  | (14,973)                  | (42,611)                  |
| Purchases of available-for-sale investments                                       | (109,313)                 | (107,639)                 |
| Purchases of held-to-maturity investments   | (5,175)                   | (2,000)                   |
| Maturities and sales from available-for-sale investments                          | 77,530                    | 110,618                   |
| Net cash used in investing activities   | \$ (51,931)               | \$ (41,632)               |
| Net decrease in cash and equivalents  | (15,503)                  | (4,114)                   |
| Cash and equivalents, beginning of period   | 54,782                    | 61,801                    |
| Cash and equivalents, end of period   | \$ 39,279                 | \$ 57,687                 |
| Supplemental disclosures of cash flow information:                                |                           |                           |
| Cash paid during the period for income taxes                                      | \$ 7,318                  | \$ 12,869                 |
| Noncash investing and operating activities  |                           |                           |

Edgar Filing: DSW Inc. - Form 10-Q

|  |    |         |    |       |
|--|----|---------|----|-------|
| Increase (decrease) in accounts payable and accrued expenses from asset purchases  | \$ | (1,840) | \$ | 1,312 |
| (Decrease) in accounts payable related to recovery from parent of impairment<br>related to certain shared service assets | \$ | (1,818) |    |       |

The accompanying Notes are an integral part of the Condensed Consolidated Financial Statements

**Table of Contents**

**DSW INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)**

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation*** The accompanying unaudited condensed consolidated interim financial statements should be read in conjunction with the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission (SEC) on April 1, 2009 (the 2008 Annual Report).

In the opinion of management, the unaudited condensed consolidated interim financial statements reflect all adjustments, consisting of normal recurring adjustments, which are necessary to present fairly the consolidated financial position, results of operations and cash flows for the periods presented.

***Business Operations*** DSW Inc. (DSW) and its wholly-owned subsidiaries are herein referred to collectively as DSW or the Company. DSW's Class A Common Shares are listed on the New York Stock Exchange trading under the ticker symbol DSW. As of August 1, 2009, Retail Ventures, Inc. (RVI or Retail Ventures) owned approximately 62.8% of DSW's outstanding Common Shares, representing approximately 93.1% of the combined voting power of DSW's outstanding Common Shares.

As of August 1, 2009, DSW operated 306 stores located throughout the United States and dsw.com. DSW stores and dsw.com offer a wide selection of better-branded dress, casual and athletic footwear for men and women, as well as accessories. During the six months ended August 1, 2009, DSW opened eight new DSW stores. DSW also operates leased departments for four retailers in its leased department segment. As of August 1, 2009, DSW operated leased departments in 269 Stein Mart stores, 65 Gordmans stores, 23 Filene's Basement stores and one Frugal Fannie's store. During the six months ended August 1, 2009, DSW added one leased department and ceased operations in 20 leased departments. DSW owns the merchandise, records sales of merchandise net of returns and sales tax, owns the fixtures (except for Filene's Basement) and provides management oversight in these locations. Stein Mart, Gordmans, Filene's Basement and Frugal Fannie's provide the sales associates. DSW pays a percentage of net sales as rent.

***Allowance for Doubtful Accounts*** The Company monitors its exposure for losses and records related allowances for doubtful accounts. Allowances are estimated based upon specific accounts receivable balances, where a risk of default has been identified. As of August 1, 2009 and January 31, 2009, the Company's allowance for doubtful accounts was \$1.5 million and \$0.8 million, respectively. The increase in the allowance is primarily related to the collectability of a receivable from liquidating Filene's Basement. All references to liquidating Filene's Basement refer to the entity remaining after the asset purchase by a subsidiary of Syms Corp (Syms). All other references to Filene's Basement refer to the stores operated by Syms.

***Inventories*** Merchandise inventories are stated at net realizable value, determined using the first-in, first-out basis, or market, using the retail inventory method. The retail method is widely used in the retail industry due to its practicality. Under the retail inventory method, the valuation of inventories at cost and the resulting gross profits are calculated by applying a calculated cost to retail ratio to the retail value of inventories. The cost of the inventory reflected on the balance sheet is decreased by charges to cost of sales at the time the retail value of the inventory is lowered through the use of markdowns, which are reductions in prices due to customers' perception of value. Hence, earnings are negatively impacted as the merchandise is marked down prior to sale.

Inherent in the calculation of inventories are certain significant management judgments and estimates, including setting the original merchandise retail value, markdowns, and estimates of losses between physical inventory counts, or shrinkage, which combined with the averaging process within the retail method, can significantly impact the ending inventory valuation at cost and the resulting gross profit.

***Tradenames and Other Intangible Assets, net*** Tradenames and other intangible assets are comprised of values assigned to names the Company acquired and leases acquired. The accumulated amortization for these assets is \$9.7 million and \$9.2 million as of August 1, 2009 and January 31, 2009, respectively.



**Table of Contents**

**DSW INC.**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

The asset value and accumulated amortization of intangible assets is as follows:

|   | August 1,<br>2009 | January 31,<br>2009 |
|---|-------------------|---------------------|
|   | (in thousands)    |                     |
| Not subject to amortization                 |                   |                     |
| Domain names                                | \$ 21             | \$ 21               |
| Subject to amortization                     |                   |                     |
| Tradenames:                                 |                   |                     |
| Gross asset                                 | \$ 12,750         | \$ 12,750           |
| Accumulated amortization                    | (9,563)           | (9,138)             |
| Subtotal                                    | \$ 3,187          | \$ 3,612            |
| Favorable leases:                           |                   |                     |
| Gross asset                                 | \$ 140            | \$ 140              |
| Accumulated amortization                    | (107)             | (105)               |
| Subtotal                                    | \$ 33             | \$ 35               |
| Tradenames and other intangible assets, net | \$ 3,241          | \$ 3,668            |

Amortization expense for each of the three and six months ended August 1, 2009 and August 2, 2008 was \$0.2 million and \$0.4 million, respectively. Amortization associated with the net carrying amount of intangible assets as of August 1, 2009 is estimated to be \$0.5 million for the remainder of fiscal 2009, \$0.9 million for each fiscal year from fiscal 2010 through fiscal 2012 and \$0.2 million in fiscal 2013.

**Customer Loyalty Program** The Company maintains a customer loyalty program for the DSW stores and dsw.com in which program members earn reward certificates that result in discounts on future purchases. Upon reaching the target-earned threshold, the members receive reward certificates for these discounts which must be redeemed within six months. The Company accrues the anticipated redemptions of the discount earned at the time of the initial purchase. To estimate these costs, DSW is required to make assumptions related to customer purchase levels and redemption rates based on historical experience. The accrued liability as of August 1, 2009 and January 31, 2009 was \$7.8 million and \$7.3 million, respectively.

**Deferred Rent** Many of the Company's operating leases contain predetermined fixed increases of the minimum rentals during the initial lease terms. For these leases, the Company recognizes the related rental expense on a straight-line basis over the original terms of the lease. The Company records the difference between the amount charged to expense and the rent paid as deferred rent and begins amortizing such deferred rent upon the delivery of the lease location by the lessor. The deferred rent included in the other non-current liabilities caption was \$32.6 million and \$31.9 million as of August 1, 2009 and January 31, 2009, respectively.

**Construction and Tenant Allowances** The Company receives cash allowances from landlords, which are deferred and amortized on a straight-line basis over original terms of the lease as a reduction of rent expense. Construction and tenant allowances are included in the caption other non-current liabilities and were \$62.3 million and \$63.7 million as of August 1, 2009 and January 31, 2009, respectively.

**Accumulated Other Comprehensive Loss** Accumulated other comprehensive loss of \$0.7 million as of both August 1, 2009 and January 31, 2009 relates to the Company's unrealized losses on available-for-sale securities.

The Company believes that it is more likely than not that it would not be able to utilize the related deferred tax assets and recorded a valuation allowance against the related deferred tax assets at August 1, 2009 and January 31, 2009. For the six months ended August 1, 2009 and August 2, 2008, total comprehensive income was \$14.6 million and \$21.1 million, respectively.

***Sales and Revenue Recognition*** Revenues from merchandise sales are recognized upon customer receipt of merchandise, are net of returns and sales tax and are not recognized until collectability is reasonably assured. For dsw.com, the Company estimates a time lag for shipments to record revenue when the customer receives the goods. Net sales also include revenue from shipping and handling while the related costs are included in cost of sales.

Revenue from gift cards is deferred and recognized upon redemption of the gift card. The Company's policy is to recognize income from breakage of gift cards when the likelihood of redemption of the gift card is remote. The Company recognized \$0.2 million as miscellaneous income from gift card breakage during each of the three months ended August 1, 2009 and August 2, 2008, and DSW recognized \$0.4 million and \$0.3 million as miscellaneous income from gift card breakage during the six months ended August 1, 2009 and August 2, 2008, respectively.



**Table of Contents****DSW INC.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)**

**Cost of Sales** In addition to the cost of merchandise, the Company includes in the cost of sales expenses associated with warehousing (including depreciation), distribution and store occupancy (excluding depreciation but including impairments). Warehousing costs are comprised of labor, benefits and other labor-related costs associated with the operations of the distribution and fulfillment centers. The non-labor costs associated with warehousing include rent, depreciation, insurance, utilities, maintenance and other operating costs that are passed to the Company from the landlord. Distribution costs include the transportation of merchandise to the distribution and fulfillment centers, from the distribution center to the Company's stores and from the fulfillment center to the customer. Store occupancy costs include rent, utilities, repairs, maintenance, insurance, janitorial costs and occupancy-related taxes, which are primarily real estate taxes passed to the Company by its landlords.

**Operating Expenses** Operating expenses include expenses related to store management and store payroll costs, advertising, leased department operations, store depreciation and amortization, pre-opening advertising and other pre-opening costs (which are expensed as incurred) and corporate expenses. Corporate expenses include expenses related to buying, information technology, depreciation expense for corporate cost centers, marketing, legal, finance, outside professional services, customer service center expenses, allocable costs to and from Retail Ventures, payroll and benefits for associates and payroll taxes. Corporate level expenses are primarily attributable to operations at the corporate offices in Columbus, Ohio.

**Non-operating Income** Non-operating income includes the realized gain on disposition of investments and other-than-temporary impairments related to investments.

**Income Taxes** Income taxes are accounted for using the asset and liability method as required by the Financial Accounting Standards Board (FASB). Under this method, deferred income taxes arise from temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. A valuation allowance is established against deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

**Subsequent Events** The Company has evaluated subsequent events through September 3, 2009, the date the Company's financial statements were issued.

***Recent Accounting Pronouncements***

In February 2008, the FASB issued FASB Staff Position 157-2, *Effective Date of FASB Statement No. 157*, (FSP 157-2), which delays the effective date of FASB Statement No. 157, *Fair Value Measurements* (FAS 157) for non-financial assets and liabilities that are recognized or disclosed in the financial statements on a nonrecurring basis to fiscal years beginning after November 15, 2008. FAS 157, which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles (GAAP) and expands disclosures about fair value measurements. The Company adopted FSP 157-2 effective February 1, 2009. Refer to Note 5 for additional information regarding the Company's fair value measurements.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3), which is effective for fiscal years beginning after December 15, 2008. FSP 142-3 removes the requirement under FASB Statement No. 142, *Goodwill and Other Intangible Assets* to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions, and replaces it with a requirement that an entity consider its own historical experience in renewing similar arrangements. The Company was required to adopt FSP 142-3 on February 1, 2009. The adoption of FSP 142-3 did not have an impact on the Company's consolidated financial statements.

In June 2008, the FASB issued FSP Emerging Issues Task Force No. 03-6-1 (FSP EITF 03-6-1), *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. The Company was required to adopt FSP EITF 03-6-1 on February 1, 2009. The adoption of FSP EITF 03-6-1 did not have an impact on the Company's consolidated financial statements.



**Table of Contents****DSW INC.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)**

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are not Orderly* ( FSP 157-4 ), which the Company adopted for the quarter ended August 1, 2009. FSP 157-4 affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The FSP provides guidance for estimating fair value when the volume and level of market activity for an asset or liability have significantly decreased and determining whether a transaction was orderly. This FSP applies to all fair value measurements when appropriate. The adoption of FSP 157-4 did not have an impact on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ( FSP 115-2 ), which the Company adopted for the quarter ended August 1, 2009. FSP 115-2 amends existing guidance for determining whether an other-than-temporary impairment of debt securities has occurred. FSP 115-2 replaces the existing requirement that an entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert (a) it does not have the intent to sell the security, and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. The adoption of FSP 115-2 did not have an impact on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP 107-1 ), which the Company adopted for the quarter ended August 1, 2009. FSP 107-1 requires an entity to provide the annual disclosures required by FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, in its interim financial statements. The adoption of FSP 107-1 did not have an impact on the Company's consolidated financial statements.

In May 2009, the FASB issued FASB Statement No. 165, *Subsequent Events* ( FAS 165 ). FAS 165 requires an entity to disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. This statement should not result in significant changes in the subsequent events the entity reports, either through recognition or disclosure, in its financial statements. FAS 165 is effective for interim periods or fiscal years ending after June 15, 2009. The adoption of FAS 165 did not have an impact on the Company's consolidated financial statements.

In June 2009, the FASB issued the FASB Statement No. 168, *FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* ( FAS 168 ). The Codification will be the sole source of authoritative U.S. accounting and reporting standards recognized by the FASB. Rules and interpretive releases of the SEC are also sources of authoritative GAAP. FAS 168 is effective for financial statements issued for periods ending after September 15, 2009. The adoption of FAS 168 will not have an impact on the Company's financial position or results of operations. Upon adoption of FAS 168, references within financial statement disclosures will be modified to reference the Codification.

**2. RELATED PARTY TRANSACTIONS**

**Schottenstein Stores Corporation ( SSC )** The Company leases certain store, office space and distribution center locations owned by entities affiliated with SSC. Accounts receivable from and payable to affiliates principally result from commercial transactions with entities owned or affiliated with SSC or intercompany transactions with SSC. Related party receivables and payables normally settle in the form of cash in 30 to 60 days. These related party balances as of August 1, 2009 and January 31, 2009, were related party receivables of \$0.2 million and \$0.3 million, respectively, and related party payables of \$0.5 million and \$0.7 million, respectively.

**RVI and Filene's Basement** On April 21, 2009, Retail Ventures disposed of its Filene's Basement subsidiary to FB II Acquisition Corp., a newly formed entity owned by the Buxbaum Group. As a result of this disposal, liquidating Filene's Basement is no longer a related party and after this date balances are no longer related party

balances. Accounts receivable from liquidating Filene's Basement of \$1.8 million was included in the net related party payable as of January 31, 2009.

Accounts payable to RVI of \$1.7 million and \$3.4 million as of August 1, 2009 and January 31, 2009, respectively, were related to usage of RVI's net operating losses under the Tax Separation Agreement and shared services. In the second quarter of 2009, DSW recovered \$1.8 million related to impairment of certain shared service assets from RVI as allowed under the Amended and Restated Shared Service Agreement, which resulted in a reduction of the accounts payable to RVI.

Table of Contents

**DSW INC.**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**Value City** On October 26, 2008, Value City filed for bankruptcy protection and announced that it would close its remaining stores. DSW negotiated an agreement with Value City to continue to provide services post bankruptcy filing, including risk management, financial services, benefits administration, payroll and information technology services, in exchange for a weekly payment. DSW received \$0.2 million and \$0.3 million, respectively, for the three and six months ended August 1, 2009 related to services provided post bankruptcy filing. DSW submitted a proof of claim in the bankruptcy proceeding seeking payment in full of \$6.7 million for all amounts owed, however, there is no assurance that DSW can collect all or any of the amounts owed. Of the bankruptcy claim, DSW did not recognize a receivable related to the majority of the services provided and of the receivable recognized, DSW fully reserved an amount of \$0.8 million.

**3. STOCK BASED COMPENSATION**

DSW has a 2005 Equity Incentive Plan ( the Plan ) that provides for the issuance of equity awards to purchase up to 7.6 million common shares, including stock options and restricted stock units to management, key employees of DSW and affiliates, consultants (as defined in the Plan) and directors of DSW. During the three months ended August 1, 2009 and August 2, 2008, the Company recorded stock based compensation expense of approximately \$1.6 million and \$0.9 million, respectively, and during the six months ended August 1, 2009 and August 2, 2008, the Company recorded stock based compensation expense of approximately \$2.9 million and \$2.0 million.

**Stock Options** The following table summarizes the Company's stock option activity (in thousands):

|                                  | Six months<br>ended<br>August 1, 2009 |
|----------------------------------|---------------------------------------|
| Outstanding, beginning of period | 2,125                                 |
| Granted                          | 934                                   |
| Exercised                        |                                       |
| Forfeited                        | (304)                                 |
| Outstanding, end of period       | 2,755                                 |
| Exercisable, end of period       | 1,860                                 |

The weighted-average grant date fair value of each option granted in the three months ended August 1, 2009 and August 2, 2008 was \$6.42 and \$6.10 per share, respectively, and was \$5.07 and \$5.88, respectively, per share for the six months ended August 1, 2009 and August 2, 2008. The following table illustrates the weighted-average assumptions used in the Black-Scholes option-pricing model for options granted in each of the periods presented.

|   | Six months ended<br>August 1,<br>2009 | August 2,<br>2008 |
|---|---------------------------------------|-------------------|
| Assumptions:                            |                                       |                   |
| Risk-free interest rate                 | 1.9%                                  | 2.7%              |
| Expected volatility of DSW common stock | 57.6%                                 | 48.1%             |
| Expected option term                    | 4.9 years                             | 4.9 years         |
| Expected dividend yield                 | 0.0%                                  | 0.0%              |

**Restricted Stock Units** The following table summarizes the Company's restricted stock unit activity (in thousands):

|                                  | Six months<br>ended<br>August 1, 2009 |
|----------------------------------|---------------------------------------|
| Outstanding, beginning of period | 226                                   |
| Granted                          | 177                                   |
| Vested                           | (73)                                  |
| Forfeited                        | (58)                                  |
| Outstanding, end of period       | 272                                   |

The total aggregate intrinsic value of nonvested restricted stock units as of August 1, 2009 was \$3.7 million. As of August 1, 2009, the total compensation cost related to nonvested restricted stock units not yet recognized was approximately \$2.7 million with a weighted average expense recognition period remaining of 2.0 years. The weighted average exercise price for all restricted stock units is zero.

**Director Stock Units** DSW issues stock units to directors who are not employees of DSW or RVI. During the six months ended August 1, 2009 and August 2, 2008, DSW granted 45,130 and 41,229 director stock units, respectively, and expensed \$0.6 million in each respective six month period for these grants. As of August 1, 2009, 128,331 director stock units had been issued and no director stock units had been settled.

**Table of Contents**

**DSW INC.**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**4. INVESTMENTS**

The Company determines the appropriate balance sheet classification of its investments at the time of purchase and evaluates the classification at each balance sheet date. If the Company has the intent and ability to hold the investments to maturity, investments are classified as held-to-maturity. Held-to-maturity securities are stated at amortized cost plus accrued interest. As of August 1, 2009, the Company had held-to-maturity investments of \$5.2 million in tax exempt term notes that will mature in the third quarter of fiscal 2009. All other investments are classified as available-for-sale and stated at current market value.

Short-term investments classified as available-for-sale as of August 1, 2009 and January 31, 2009 include tax exempt, tax advantaged and taxable bonds, variable rate demand notes, tax exempt commercial paper, certificates of deposit and an auction rate security. The Company also participates in the Certificate of Deposit Account Registry Service® ( CDARS ). CDARS provides FDIC insurance on deposits of up to \$50.0 million. Certificates of deposit mature every 28 to 91 days. The other types of short-term investments generally have interest reset dates of every 3 to 7 days. Despite the long-term nature of the stated contractual maturities of certain short-term investments, the Company has the ability to quickly liquidate these securities. As a result, the Company has classified these securities as available-for-sale.

For the six months ended August 1, 2009, the Company recorded a net temporary impairment of less than \$0.1 million related to its auction rate security. In the second quarter of fiscal 2009, the Company recorded an unrealized gain of \$0.2 million related to this security. The net impairment recorded during the six months ended August 1, 2009 is in addition to temporary impairments of \$0.7 million recorded in fiscal 2008 related to this security. The Company believes the impairment is temporary as the security is a perpetual preferred security that possesses certain debt-like characteristics and the Company believes it has the ability to hold the security until it can recover its value.

In the first quarter of fiscal 2009, the Company received preferred shares as distributions-in-kind on two of its auction rate securities. DSW sold these preferred shares during the second quarter of fiscal 2009 for a realized gain of \$0.5 million, excluding the other-than-temporary impairments recorded in fiscal 2008 and the first quarter of fiscal 2009.

The following table discloses the major categories of the Company's investments as of August 1, 2009 and January 31, 2009:

|  | Short-term investments, net |                     | Long-term investments, net |                     |
|--|-----------------------------|---------------------|----------------------------|---------------------|
|  | August 1,<br>2009           | January 31,<br>2009 | August 1,<br>2009          | January 31,<br>2009 |
|  | (in thousands)              |                     |                            |                     |
| Available-for-sale:  |                             |                     |                            |                     |
| Tax exempt, tax advantaged and taxable bonds                       | \$ 106,186                  | \$ 65,829           |                            |                     |
| Variable rate demand notes   | 13,555                      | 16,580              |                            |                     |
| Tax exempt commercial paper  |                             | 2,000               |                            |                     |
| Certificates of deposit  | 13,000                      | 14,000              |                            |                     |
| Auction rate securities  | 2,500                       | 3,650               |                            | \$ 2,400            |
| Other-than-temporary impairment                                    |                             |                     |                            | (1,134)             |
| Unrealized losses included in accumulated other comprehensive loss | (729)                       | (655)               |                            |                     |
| Total available-for-sale   | \$ 134,512                  | \$ 101,404          |                            | \$ 1,266            |
| Held-to-maturity:  |                             |                     |                            |                     |
| Tax exempt term notes  | \$ 5,175                    |                     |                            |                     |

|                   |            |            |          |
|-------------------|------------|------------|----------|
| Total investments | \$ 139,687 | \$ 101,404 | \$ 1,266 |
|-------------------|------------|------------|----------|

## 5. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Therefore, fair value is a market-based measurement based on assumptions of the market participants. As a basis for these assumptions, DSW classifies its fair value measurements under the following fair value hierarchy:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that are publicly accessible. Active markets have frequent transactions with enough volume to provide ongoing pricing information.



**Table of Contents**

**DSW INC.**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

Level 2 inputs are other than level 1 inputs that are directly or indirectly observable. These can include unadjusted quoted prices for similar assets or liabilities in active markets, unadjusted quoted prices for identical assets or liabilities in inactive markets, or other observable inputs.

Level 3 inputs are unobservable inputs.

Financial assets and liabilities measured at fair value on a recurring basis as of August 1, 2009 consisted of the following:

|                             | Balance as<br>of<br>August 1,<br>2009 | Level 1        | Level 2    | Level 3  |
|-----------------------------|---------------------------------------|----------------|------------|----------|
|                             |                                       | (in thousands) |            |          |
| Assets:                     |                                       |                |            |          |
| Cash and equivalents        | \$ 39,279                             | \$ 39,279      |            |          |
| Short-term investments, net | 139,687                               |                | \$ 137,916 | \$ 1,771 |
|                             | \$ 178,966                            | \$ 39,279      | \$ 137,916 | \$ 1,771 |

Cash and equivalents primarily represent cash deposits and investments in money market funds held with financial institutions, as well as credit card receivables that settle in fewer than three days. The Company's investment in an auction rate security is recorded at fair value using an income approach valuation model that uses level 3 inputs such as the financial condition of the issuers of the underlying securities, expectations regarding the next successful auction, risks in the auction rate securities market and other various assumptions. The Company's other types of investments are valued using a market based approach using level 2 inputs such as prices of similar assets in active markets.

The activity related to level 3 fair value measurements for the six months ended August 1, 2009 is summarized below:

|  | Short-term<br>investments,<br>net | Long-term<br>investments,<br>net |
|--|-----------------------------------|----------------------------------|
|  | (in thousands)                    |                                  |
| Carrying value as of January 31, 2009                              | \$ 1,845                          | \$ 1,266                         |
| Transfer out of level 3  |                                   | (1,266)                          |
| Unrealized losses included in accumulated other comprehensive loss | (74)                              |                                  |
| Carrying value as of August 1, 2009                                | \$ 1,771                          | \$ 0                             |

Non-financial assets and liabilities measured at fair value on a nonrecurring basis as of August 1, 2009 consisted of the following:

|         | Balance as<br>of<br>August 1,<br>2009 | Level 1        | Level 2 | Level 3 |
|---------|---------------------------------------|----------------|---------|---------|
|         |                                       | (in thousands) |         |         |
| Assets: |                                       |                |         |         |

|                                       |    |     |    |     |
|---------------------------------------|----|-----|----|-----|
| Long-lived assets to be held and used | \$ | 398 | \$ | 398 |
|                                       | \$ | 398 | \$ | 398 |

Long-lived assets to be held and used with a carrying amount of \$2.0 million were written down to their fair value of \$0.4 million, resulting in an impairment charge of \$1.6 million, which was included in earnings for the six months ended August 1, 2009. The impairment charge does not include any impairment related to the shared service assets as RVI reimbursed DSW for the impairment in full.

The Company periodically evaluates the carrying amount of its long-lived assets, primarily property and equipment, and finite life intangible assets when events and circumstances warrant such a review to ascertain if any assets have been impaired. The carrying amount of a long-lived asset is considered impaired when the carrying value of the asset exceeds the expected future cash flows from the asset. The Company reviews are conducted at the lowest identifiable level, which include a store. The impairment loss recognized is the excess of the carrying value of the asset over its fair value, based on a discounted cash flow analysis using a discount rate determined by management. Should an impairment loss be realized, it will generally be included in cost of sales. The impairment charges were recorded within the DSW reportable segment.

Table of Contents

**DSW INC.**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**6. EARNINGS PER SHARE**

Basic earnings per share are based on net income and a simple weighted average of Class A and Class B common shares and director stock units outstanding. Diluted earnings per share are calculated using the treasury stock method and reflect the potential dilution of Class A common shares related to outstanding stock options and restricted stock units. The numerator for the diluted earnings per share calculation is net income. The denominator is the weighted average diluted shares outstanding.

|  | Three months ended |                   | Six months ended  |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | August 1,<br>2009  | August 2,<br>2008 | August 1,<br>2009 | August 2,<br>2008 |
|  | (in thousands)     |                   |                   |                   |
| Weighted average shares outstanding                            | 44,074             | 43,999            | 44,046            | 43,983            |
| Assumed exercise of dilutive restricted stock units            | 346                | 243               | 309               | 212               |
| Number of shares for computation of diluted earnings per share | 44,420             | 44,242            | 44,355            | 44,195            |

Options to purchase 2.7 million and 1.6 million common shares were outstanding as of August 1, 2009 and August 2, 2008, respectively, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares for the period, and therefore, the effect would be anti-dilutive.

**7. DSW \$150 MILLION CREDIT FACILITY**

**DSW \$150 Million Credit Facility** The Company has a \$150 million secured revolving credit facility with a term of five years that will expire on July 5, 2010. Under this facility, the Company and its subsidiaries are named as co-borrowers. The facility has borrowing base restrictions and provides for borrowings at variable interest rates based on LIBOR, the prime rate and the Federal Funds effective rate, plus a margin. The Company's obligations under this facility are secured by a lien on substantially all of its and its subsidiary's personal property and a pledge of its shares of DSW Shoe Warehouse, Inc. (DSWSW). In addition, the secured revolving credit facility contains usual and customary restrictive covenants relating to the management and the operation of the business. These covenants, among other things, restrict the Company's ability to grant liens on its assets, incur additional indebtedness, open or close stores, pay cash dividends and redeem its stock, enter into transactions with affiliates and merge or consolidate with another entity. In addition, if at any time the Company utilizes over 90% of its borrowing capacity under the facility, the Company must comply with a fixed charge coverage ratio test set forth in the facility documents. The Company intends to refinance the credit facility on a long-term basis. As of August 1, 2009 and January 31, 2009, the Company had no outstanding borrowings and had availability under the facility of \$129.8 million and \$132.3 million, respectively. The Company had outstanding letters of credit of \$20.2 million and \$17.7 million, respectively, as of August 1, 2009 and January 31, 2009.

**8. INCOME TAXES**

The provision for income taxes is based on the current estimate of the annual effective tax rate and is adjusted as necessary for quarterly events. The Company's effective tax rate was 39.3% and 39.5%, respectively, for the three months ended August 1, 2009 and August 2, 2008 and 39.8% and 39.0%, respectively, for the six months ended August 1, 2009 and August 2, 2008.

Consistent with its historical financial reporting, the Company has elected to classify interest expense related to income tax liabilities, when applicable, as part of the interest expense in its condensed consolidated statements of income rather than income tax expense. The Company will continue to classify income tax penalties as part of operating expenses in its condensed consolidated statements of income.



**Table of Contents**

**DSW INC.**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**9. SEGMENT REPORTING**

The Company is managed in three operating segments: DSW stores, dsw.com and leased departments. DSW stores and dsw.com have been aggregated and are presented as one reportable segment, the DSW segment, based on their similar economic characteristics, products, production processes, target customers and distribution methods. The Company has identified such segments based on internal management reporting and management responsibilities and measures segment profit as gross profit, which is defined as net sales less cost of sales. All operations are located in the United States. The goodwill balance of \$25.9 million outstanding as of August 1, 2009 and January 31, 2009 is recorded in the DSW segment related to the DSW stores operating segment. The tables below present segment information for the Company's two reportable segments:

|                                    | DSW        | Leased<br>departments<br>(in thousands) | Total      |
|------------------------------------|------------|---|------------|
| Three months ended August 1, 2009: |            |   |            |
| Net sales                          | \$ 335,200 | \$ 34,290                               | \$ 369,490 |
| Gross profit                       | 92,074     | 5,714                                   | 97,788     |
| Capital expenditures               | 4,695      | 36                                      | 4,731      |
| Three months ended August 2, 2008: |            |   |            |
| Net sales                          | \$ 315,620 | \$ 41,555                               | \$ 357,175 |
| Gross profit                       | 94,334     | 6,760                                   | 101,094    |
| Capital expenditures               | 24,120     | 144                                     | 24,264     |
| Six months ended August 1, 2009:   |            |   |            |
| Net sales                          | \$ 679,328 | \$ 76,008                               | \$ 755,336 |
| Gross profit                       | 188,898    | 13,871                                  | 202,769    |
| Capital expenditures               | 13,098     | 42                                      | 13,140     |
| Six months ended August 2, 2008:   |            |   |            |
| Net sales                          | \$ 636,775 | \$ 86,664                               | \$ 723,439 |
| Gross profit                       | 183,686    | 14,455                                  | 198,141    |
| Capital expenditures               | 43,669     | 257                                     | 43,926     |
| As of August 1, 2009:              |            |   |            |
| Total assets                       | \$ 681,484 | \$ 67,032                               | \$ 748,516 |
| As of January 31, 2009:            |            |   |            |
| Total assets                       | \$ 659,876 | \$ 61,321                               | \$ 721,197 |

**10. COMMITMENTS AND CONTINGENCIES**

The Company is involved in various legal proceedings that are incidental to the conduct of its business. The Company estimates the range of liability related to pending litigation where the amount of the range of loss can be estimated. The Company records its best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss, the Company records the most likely estimated liability related to the claim. In the opinion of management, the amount of any potential liability with respect to current legal proceedings will not be material to the Company's results of operations or financial condition. As additional information becomes available, the Company will assess the potential liability related to its pending litigation and revise the estimates as needed. Revisions in its estimates and potential liability could materially impact the

Company's results of operations and financial condition.

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*All references to we, us, our, DSW or the Company in this Quarterly Report on Form 10-Q mean DSW Inc. and its wholly-owned subsidiaries, including DSW Shoe Warehouse, Inc. ( DSWSW ), except where it is made clear that the term only means DSW Inc. DSW Class A Common Shares are listed for trading under the ticker symbol DSW on the New York Stock Exchange ( NYSE ).*

*All references to Retail Ventures , or RVI , in this Quarterly Report on Form 10-Q mean Retail Ventures, Inc. and its subsidiaries, except where it is made clear that the term only means the parent company. DSW is a controlled subsidiary of Retail Ventures. RVI Common Shares are listed under the ticker symbol RVI on the NYSE.*

*On January 23, 2008, Retail Ventures disposed of an 81% ownership interest in its Value City Department Stores business to VCHI Acquisition Co., a newly formed entity owned by VCDS Acquisition Holdings, LLC, Emerald Capital Management LLC and Crystal Value, LLC.*

*On April 21, 2009, Retail Ventures disposed of its Filene's Basement subsidiary to FB II Acquisition Corp., a newly formed entity owned by the Buxbaum Group. On May 4, 2009, Filene's Basement filed a petition for bankruptcy. On June 18, 2009, SYL LLC, a subsidiary of Syms Corp, purchased certain assets of Filene's Basement.*

#### **Company Overview**

DSW is a leading U.S. branded footwear specialty retailer operating 306 shoe stores in 39 states as of August 1, 2009. We offer a wide selection of better-branded dress, casual and athletic footwear for women and men, as well as accessories. Our typical customers are brand, quality and style-conscious shoppers who have a passion for footwear and accessories. Our core focus is to create a distinctive store experience that satisfies both the rational and emotional shopping needs of our customers by offering them a vast, exciting selection of in-season styles combined with the convenience and value they desire. Our stores average approximately 22,000 square feet and carry approximately 23,000 pairs of shoes. We believe this combination of selection, convenience and value differentiates us from our competitors and appeals to consumers from a broad range of socioeconomic and demographic backgrounds. In addition, we also operate 358 leased shoe departments for four other retailers and sell shoes and accessories through dsw.com.

#### **Cautionary Statement Regarding Forward-Looking Information for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995**

Some of the statements in this Quarterly Report on Form 10-Q contain forward-looking statements which reflect our current views with respect to, among other things, future events and financial performance. You can identify these forward-looking statements by the use of forward-looking words such as outlook, believes, expects, potential, continues, may, should, seeks, approximately, predicts, intends, plans, estimates, anticipates or those words or other comparable words. Any forward-looking statements contained in this Quarterly Report on Form 10-Q are based upon our historical performance and on current plans, estimates and expectations and assumptions relating to our operations, results of operations, financial condition, growth strategy and liquidity. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future plans, estimates or expectations contemplated by us will be achieved. Such forward-looking statements are subject to numerous risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. In addition to those factors described under Part I, Item 1A. Risk Factors, in our Form 10-K filed on April 1, 2009 and Part II, Item 1A. Risk Factors in this Form 10-Q, some important factors that could cause actual results, performance or achievements for DSW to differ materially from those discussed in forward-looking statements include, but are not limited to, the following:

- our success in opening and operating new stores on a timely and profitable basis;
- continuation of supply agreements and the financial condition of our leased business partners;
- maintaining good relationships with our vendors;
- our ability to anticipate and respond to fashion trends;
- fluctuation of our comparable store sales and quarterly financial performance;
- disruption of our distribution operations;

the realization of our bankruptcy claims related to liquidating Filene's Basement and Value City Department Stores;

impact of the disposition of Filene's Basement by Retail Ventures on the allocation of expenses pursuant to the shared services agreement with RVI;

failure to retain our key executives or attract qualified new personnel;



## **Table of Contents**

our competitiveness with respect to style, price, brand availability and customer service;  
 declining general economic conditions;  
 risks inherent to international trade with countries that are major manufacturers of footwear;  
 the success of dsw.com;  
 liquidity and investment risks related to our investments;  
 RVI's lease of an office facility;  
 our ability to secure additional credit upon the termination of our existing credit facility; and  
 liquidity risks at Retail Ventures and their impact on DSW.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results, performance or achievements may vary materially from what we have projected. Furthermore, new factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of any such factor on the business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, DSW undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

### **Critical Accounting Policies**

Our critical accounting policies are described in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and in the notes to our Consolidated Financial Statements for the year ended January 31, 2009 contained in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission (SEC) on April 1, 2009 (the 2008 Annual Report). We base these estimates and judgments on our historical experience and other factors we believe to be relevant, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The process of determining significant estimates is fact-specific and takes into account factors such as historical experience, current and expected economic conditions, product mix, and in some cases, actuarial and appraisal techniques. We constantly re-evaluate these significant factors and make adjustments where facts and circumstances dictate. There have been no significant changes to our critical accounting policies since the 2008 Annual Report.

### **Results of Operations**

#### **Overview**

Comparable store sales for the first six months of fiscal 2009 decreased 3.8% compared to a decrease of 6.2% in the same period last year as the result of a difficult economic environment. Negative comparable store sales were primarily driven by a decrease in traffic and units per transaction. Despite a decrease in our comparable store sales, total sales in the first six months of fiscal 2009 increased 4.4% due to new DSW stores and dsw.com sales.

Even in these difficult economic times, we have continued to make investments in our business that are critical to our long-term growth, such as improved information technology systems and new stores. Despite our current decline in earnings and our commitment to invest in the future growth of DSW, our balance sheet remains strong. As of August 1, 2009, our cash and short-term investments balance increased to \$179.0 million and we have no long-term debt.

As of August 1, 2009, we operated 306 DSW stores in 39 states, dsw.com and leased shoe departments in 269 Stein Mart stores, 65 Gordmans stores, 23 Filene's Basement stores and one Frugal Fannie's store. We have two reportable segments, the DSW segment, which includes DSW stores and dsw.com, and the leased department segment.

**Table of Contents**

The following table sets forth, for the periods indicated, the percentage relationships to net sales of the listed items included in our condensed consolidated statements of income:

|                              | Three months ended |                   | Six months ended  |                   |
|------------------------------|--------------------|-------------------|-------------------|-------------------|
|                              | August 1,<br>2009  | August 2,<br>2008 | August 1,<br>2009 | August 2,<br>2008 |
| Net sales                    | 100.0%             | 100.0%            | 100.0%            | 100.0%            |
| Cost of sales                | (73.5)             | (71.7)            | (73.2)            | (72.6)            |
| Gross profit                 | 26.5               | 28.3              | 26.8              | 27.4              |
| Operating expenses           | (23.4)             | (23.4)            | (23.7)            | (22.7)            |
| Operating profit             | 3.1                | 4.9               | 3.1               | 4.7               |
| Interest income, net         | 0.2                | 0.2               | 0.1               | 0.1               |
| Non-operating income         | 0.1                |                   | 0.0               |                   |
| Earnings before income taxes | 3.4                | 5.1               | 3.2               | 4.8               |
| Income tax provision         | (1.3)              | (2.0)             | (1.3)             | (1.9)             |
| Net income                   | 2.1%               | 3.1%              | 1.9%              | 2.9%              |

**Key Financial Measures**

In evaluating our results of operations, we refer to a number of key financial and non-financial measures relating to the performance of our business. Among our key financial measures are net sales, operating profit and net income. Other measures that we use in evaluating our performance include number of DSW stores and leased departments, net sales per average gross square foot for DSW stores, and change in comparable stores sales. The following describes certain line items set forth in our consolidated statement of income:

*Net Sales.* We record net sales exclusive of sales tax and net of returns. For comparison purposes, we define stores and leased departments as comparable or non-comparable. A store's or leased department's sales are included in comparable sales if the store or leased department has been in operation at least 14 months at the beginning of the fiscal year. Stores and leased departments are excluded from the comparison in the quarter that they close. Stores that are remodeled or relocated are excluded from the comparison if there is a material change in the size of the store or the store is relocated more than one mile out of its area.

*Cost of Sales.* Our cost of sales includes the cost of merchandise, distribution and warehousing (including depreciation), store occupancy (excluding depreciation but including impairments), permanent and point of sale reductions, markdowns and shrinkage.

*Operating Expenses.* Operating expenses include expenses related to store management and store payroll costs, advertising, leased department operations, store depreciation and amortization, pre-opening advertising and other pre-opening costs (which are expensed as incurred) and corporate expenses. Corporate expenses include expenses related to buying, information technology, depreciation expense for corporate cost centers, marketing, legal, finance, outside professional services, customer service center expenses, allocable costs to and from Retail Ventures, payroll and benefits for associates and payroll taxes. Corporate level expenses are primarily attributable to operations at our corporate offices in Columbus, Ohio.

**THREE MONTHS ENDED AUGUST 1, 2009 COMPARED TO THREE MONTHS ENDED AUGUST 2, 2008**

*Net Sales.* Sales for the three months ended August 1, 2009 increased by 3.4% from the three months ended August 2, 2008. The following table summarizes the increase in our net sales:

Three months  
ended

|  | August 1, 2009<br>(in millions) |
|--|---------------------------------|
| Net sales for the three months ended August 2, 2008                        | \$ 357.2                        |
| Decrease in comparable store sales   | (9.8)                           |
| Net increase from 2008 and 2009 new stores, dsw.com and closed store sales | 22.1                            |
| Net sales for the three months ended August 1, 2009                        | \$ 369.5                        |

**Table of Contents**

The following table summarizes our sales breakdown by reportable segment:

|                    | Three months ended<br>August 1,<br>2009 |       | August 2, 2008<br>(in millions) |       |
|--------------------|---|-------|---------------------------------|-------|
| DSW                | \$                                      | 335.2 | \$                              | 315.6 |
| Leased departments |   | 34.3  |                                 | 41.6  |
| Total DSW Inc.     | \$                                      | 369.5 | \$                              | 357.2 |

The following table summarizes our comparable store sales by reportable segment and in total:

|                    | Three months<br>ended<br>August 1, 2009 |
|--------------------|---|
| DSW                | (2.1%)                                  |
| Leased departments | (9.9%)                                  |
| Total DSW Inc.     | (2.9%)                                  |

The decrease in comparable store sales was primarily a result of the continued challenging economic environment. In our DSW segment, this was evidenced by a decrease in traffic and units per transaction. DSW comparable sales decreased in women's by 2.4%, men's by 10.0% and the athletic category by 1.8%. For accessories, DSW comparable sales increased by 12.2% primarily due to our handbag initiative.

*Gross Profit.* Gross profit decreased 3.3% from the second quarter of fiscal 2008. Gross profit decreased as a percentage of net sales from 28.3% in the second quarter of fiscal 2008 to 26.5% in the second quarter of fiscal 2009. By reportable segment and in total, gross profit as a percentage of net sales was:

|                    | August 1,<br>2009 | August 2,<br>2008 |
|--------------------|-------------------|-------------------|
| DSW                | 27.5%             | 29.9%             |
| Leased departments | 16.7%             | 16.3%             |
| Total DSW Inc.     | 26.5%             | 28.3%             |

The decrease in gross profit was a result of the decrease in merchandise margin and an increase in store occupancy expenses as a percentage of net sales. The merchandise margin, gross profit excluding warehousing and store occupancy, for the DSW segment for the second quarter of fiscal 2009 decreased as a percentage of net sales to 43.4% compared to merchandise margin of 45.1% for the second quarter of fiscal 2008. The decrease in merchandise margin was primarily a result of a shift in clearance markdown activity related to mid-season promotional sales. Store occupancy expense for the DSW segment as a percentage of net sales increased to 14.4% for the second quarter of fiscal 2009 from 13.7% for the second quarter of fiscal 2008 as a result of decreased average store sales.

The gross profit for leased departments increased as a percentage of net sales compared to the second quarter of fiscal 2008 due to decreased markdowns. The decrease in markdowns was a result of enhancements to the clearance markdown process and aligning our inventory position to sales demand.

*Operating Expenses.* Operating expenses as a percentage of net sales were 23.4% for each respective quarter. Store and home office expenses decreased as a percentage of net sales and were offset by increases in marketing and depreciation as a percentage of net sales. Marketing expenses as a percentage of net sales increased by 80 basis points due to increases in media spending and expenses related to our DSW Rewards program. Depreciation expense increased 80 basis points due to significant capital investments in our store growth, dsw.com and system initiatives over the previous two years.

*Operating Profit.* Operating profit decreased as a percentage of net sales to 3.1% in the second quarter of fiscal 2009 from 4.9% in the second quarter of fiscal 2008. As a percentage of sales, this decrease was primarily the result of the decrease in gross profit.

*Interest Income, Net.* Interest income, net of interest expense, for the second quarter of fiscal 2009 was 0.2% as a percentage of sales for each respective quarter. While cash and short term investments increased compared to the second quarter of fiscal 2008, the increase was offset by a decrease in interest rates.

*Non-operating income.* Non-operating income for the second quarter of fiscal 2009 represents the realized gain related to the sale of our investments in preferred shares. There was no non-operating income for the second quarter of fiscal 2008.

*Income Taxes.* Our effective tax rate for the second quarter of fiscal 2009 was 39.3%, compared to 39.5% for the second quarter of fiscal 2008.

**Table of Contents**

*Net Income.* For the second quarter of fiscal 2009, net income decreased 30.9%, compared to the second quarter of fiscal 2008 and represented 2.1% and 3.1% of net sales, respectively. As a percentage of sales, this decrease was primarily the result of the decrease in gross profit.

**SIX MONTHS ENDED AUGUST 1, 2009 COMPARED TO SIX MONTHS ENDED AUGUST 2, 2008**

*Net Sales.* Sales for the six months ended August 1, 2009 increased by 4.4% from the six months ended August 2, 2008. The following table summarizes the increase in our net sales:

|  | Six months<br>ended<br>August 1, 2009<br>(in millions) |
|--|--|
| Net sales for the three months ended August 2, 2008                        | \$ 723.4   |
| Decrease in comparable store sales   | (26.3)   |
| Net increase from 2008 and 2009 new stores, dsw.com and closed store sales | 58.2   |
| Net sales for the three months ended August 1, 2009                        | \$ 755.3   |

The following table summarizes our sales breakdown by reportable segment:

|                    | Six months ended<br>August 1,<br>2009 | August 2, 2008<br>(in millions) |
|--------------------|---------------------------------------|---------------------------------|
| DSW                | \$ 679.3                              | \$ 636.8                        |
| Leased departments | 76.0                                  | 86.6                            |
| Total DSW Inc.     | \$ 755.3                              | \$ 723.4                        |

The following table summarizes our comparable store sales by reportable segment and in total:

|                    | Six months<br>ended<br>August 1, 2009 |
|--------------------|---------------------------------------|
| DSW                | (3.4%)                                |
| Leased departments | (7.2%)                                |
| Total DSW Inc.     | (3.8%)                                |

The decrease in comparable store sales was primarily a result of the continued challenging economic environment. In the DSW segment, this was evidenced by a decrease in traffic and units per transaction. DSW comparable sales decreased in women's by 3.7%, men's by 11.4% and the athletic category by 1.6%. In accessories, DSW comparable sales increased by 12.1% primarily due to our handbag initiative.

*Gross Profit.* Gross profit increased 2.3% from the six months ended August 2, 2008. Gross profit decreased as a percentage of net sales from 27.4% for the six months ended August 2, 2008 to 26.8% for the six months ended August 1, 2009. By reportable segment and in total, gross profit as a percentage of net sales was:

|                    | August 1,<br>2009 | August 2,<br>2008 |
|--------------------|-------------------|-------------------|
| DSW                | 27.8%             | 28.8%             |
| Leased departments | 18.2%             | 16.7%             |
| Total DSW Inc.     | 26.8%             | 27.4%             |

The decrease in gross profit was a result of the decrease in merchandise margin and an increase in store occupancy and distribution expenses as a percentage of net sales. The merchandise margin, gross profit excluding warehousing and store occupancy, for the DSW segment for the six months ended August 1, 2009 decreased as a percentage of net sales to 43.6% compared to merchandise margin of 43.9% for the six months ended August 2, 2008. The increase in distribution expense as a percentage of net sales to 1.6% from 1.4% was primarily a result of expenses related to the dsw.com fulfillment center. Store occupancy expense for the DSW segment as a percentage of net sales increased to 14.2% for the six months ended August 1, 2009 from 13.6% for the six months ended August 2, 2008 as a result of decreased average store sales.

The gross profit for leased departments increased as a percentage of net sales compared to the six months ended August 2, 2008 due to decreased markdowns. The decrease in markdowns was a result of enhancements to the clearance markdown process and aligning our inventory position to sales demand.

*Operating Expenses.* For the six months ended August 1, 2009, operating expenses increased as a percentage of net sales to 23.7% from 22.7% for the six months ended August 2, 2008. The increase in operating expenses as a percentage of net sales was the result of an increase in marketing and depreciation expense partially offset by decreases as a percentage of net sales in store and home office expenses. Marketing expenses as a percentage of net sales increased by 110 basis points due to increases in media and broadcast production spending, as well as an increase in expenses related to our DSW Rewards program. Depreciation expense increased 80 basis points due to significant capital investments in our store growth, dsw.com and system initiatives over the previous two years.

## **Table of Contents**

*Operating Profit.* Operating profit decreased as a percentage of net sales to 3.1% for the six months ended August 1, 2009 from 4.7% for the six months ended August 2, 2008. As a percentage of sales, this decrease was primarily the result of the decrease in gross profit and the increase in operating expenses.

*Interest Income, Net.* Interest income, net of interest expense, for the second quarter of fiscal 2009 was 0.1% as a percentage of sales for each respective quarter. While cash and short term investments increased compared to the six months ended August 2, 2008, the increase was offset by a decrease in interest rates.

*Non-operating income.* Non-operating income for the six months ended August 1, 2009 represents the realized gain related to the sale of our investments in preferred shares. There was no non-operating income for the six months ended August 2, 2008.

*Income Taxes.* Our effective tax rate for the six months ended August 1, 2009 was 39.8%, compared to 39.0% for the six months ended August 2, 2008.

*Net Income.* For the six months ended August 1, 2009, net income decreased 30.8% compared to the second quarter of fiscal 2008 and represented 1.9% and 2.9% of net sales, respectively. As a percentage of sales, this decrease was primarily the result of the decrease in gross profit and the increase in operating expenses.

### **Seasonality**

Our business is subject to seasonal trends. The sales in our DSW stores have typically been higher in the first and third quarters, when our customers' interest in new seasonal styles increases. Unlike many other retailers, we have not historically experienced a large increase in net sales during our fourth quarter associated with the winter holiday season.

### **Liquidity and Capital Resources**

Our primary ongoing cash flow requirements are for seasonal and new store inventory purchases, capital expenditures in connection with our store expansion, improving our information systems, dsw.com, the remodeling of existing stores and infrastructure growth. Our working capital and inventory levels typically build seasonally. We believe that we have sufficient financial resources and access to financial resources at this time. We are committed to a cash management strategy that maintains liquidity to adequately support the operation of the business, our growth strategy and to withstand unanticipated business volatility. We believe that cash generated from DSW operations, together with our current levels of cash and equivalents and short-term investments as well as availability under our revolving credit facility, will be sufficient to maintain our ongoing operations, support seasonal working capital requirements and fund capital expenditures related to projected business growth.

Although our plan of continued expansion could place increased demands on our financial, managerial, operational and administrative resources, we do not believe that our anticipated growth plan will have an unfavorable impact on our operations or liquidity. The current slowdown in the United States economy has adversely affected consumer confidence and consumer spending habits, which may result in further reductions in comparable store sales in our existing stores with the resultant increase in inventory levels and markdowns. Reduced sales may result in reduced operating cash flows if we are not able to appropriately manage inventory levels or leverage expenses. These negative economic conditions may also affect future profitability and may cause us to reduce the number of future store openings, impair goodwill or impair long-lived assets.

*Net Working Capital.* Net working capital increased \$33.1 million to \$328.8 million as of August 1, 2009 from \$295.7 million at January 31, 2009, primarily due to the increase of short term investments from operating cash flows. The increase is also a result of the increase in inventory related to the fall season. At August 1, 2009 and January 31, 2009, the current ratio was 3.0 and 2.9, respectively.

*Operating Cash Flows.* For the six months ended August 1, 2009, our net cash provided by operations was \$36.4 million, compared to \$37.5 million for the three months ended August 2, 2008.

*Investing Cash Flows.* For the six months ended August 1, 2009, our net cash used in investing activities was \$51.9 million compared to \$41.6 million for the six months ended August 2, 2008. The increase in net cash used in investing activities is a result of a decrease in maturities and sales of available-for-sale securities partially offset by a decrease in capital expenditures. During the six months ended August 1, 2009, we incurred \$13.1 million in capital expenditures. Of this incurred amount, we incurred \$5.9 million related to stores, \$2.8 million related to supply chain projects and warehouses and \$4.4 million related to information technology equipment upgrades and new systems.





**Table of Contents**

We expect to spend approximately \$30 million for capital expenditures in fiscal 2009. We will open nine stores in fiscal 2009. During fiscal 2008, the average investment required to open a typical new DSW store was approximately \$1.6 million, prior to construction and tenant allowances. Of this amount, gross inventory typically accounted for \$0.5 million, fixtures and leasehold improvements typically accounted for \$1.0 million and pre-opening advertising and other pre-opening expenses typically accounted for \$0.1 million. Our future capital expenditures will depend heavily on the number of new stores we open, the number of existing stores we remodel, our information technology and system investments and the timing of these expenditures.

*\$150 Million Secured Revolving Credit Facility.* We have a \$150 million secured revolving credit facility that expires July 5, 2010. Under this facility, we and our subsidiaries are named as co-borrowers. Our facility has borrowing base restrictions and provides for borrowings at variable interest rates based on LIBOR, the prime rate and the Federal Funds effective rate, plus a margin. Our obligations under this credit facility are secured by a lien on substantially all of our and our subsidiary's personal property and a pledge of our shares of DSW Shoe Warehouse. In addition, our secured revolving credit facility contains usual and customary restrictive covenants relating to our management and the operation of our business. These covenants, among other things, restrict our ability to grant liens on our assets, incur additional indebtedness, open or close stores, pay cash dividends and redeem our stock, enter into transactions with affiliates and merge or consolidate with another entity. In addition, if at any time we utilize over 90% of our borrowing capacity under this facility, we must comply with a fixed charge coverage ratio test set forth in the facility documents. At August 1, 2009 and January 31, 2009, \$129.8 million and \$132.3 million, respectively, were available under the \$150 million secured revolving credit facility and no direct borrowings were outstanding.

We are currently seeking a new secured revolving credit facility as our current credit facility will expire in July 2010. Based upon the current credit markets, the terms of the new credit facility may not be as favorable as our current terms.

**Contractual Obligations**

DSW had outstanding letters of credit that totaled \$20.2 million as of August 1, 2009 and \$17.7 million as of January 31, 2009. If certain conditions are met under these arrangements, the Company would be required to satisfy the obligations in cash. Due to the nature of these arrangements and based on historical experience and other factors, DSW does not expect to make any significant payments outside of terms set forth in these arrangements.

As of August 1, 2009, we have entered into various construction commitments, including capital items to be purchased for projects that were under construction, or for which a lease has been signed. Our obligations under these commitments aggregated to \$0.1 million as of August 1, 2009. In addition, we have signed lease agreements for three new store locations expected to be opened over the next 18 months, with total annual rent of approximately \$0.9 million. In connection with the new lease agreements, we will receive a total of \$1.2 million of construction and tenant allowance reimbursements for expenditures at these locations.

We operate all our stores, warehouses and corporate office space from leased facilities. Lease obligations are accounted for either as operating leases or as capital leases based on lease by lease review at lease inception. The Company had no capital leases outstanding as of August 1, 2009 or January 31, 2009.

**Off-Balance Sheet Arrangements**

As of August 1, 2009, the Company has not entered into any off-balance sheet arrangements, as that term is described by the SEC.

**Proposed Accounting Standards**

The Financial Accounting Standards Board ( FASB ) periodically issues Statements of Financial Accounting Standards, some of which require implementation by a date falling within or after the close of the fiscal year. See Note 1 to the Condensed Consolidated Financial Statements for a discussion of the new accounting standards implemented.

In November 2008, the SEC released a proposed roadmap regarding the potential mandatory adoption of International Financial Reporting Standards ( IFRS ). Under the proposed roadmap, as an accelerated filer, we may be required to prepare financial statements in accordance with IFRS as early as 2015. In 2011, the SEC will decide on the mandatory adoption of IFRS. We are currently assessing the implications should we be required to adopt IFRS in the future.



**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Our cash and equivalents have maturities of 90 days or fewer. We also have investments in tax exempt, tax advantaged and taxable bonds, tax exempt term notes, variable rate demand notes, certificates of deposit and an auction rate security. We have \$13.0 million invested in certificates of deposit and participate in the Certificate of Deposit Account Registry Service® ( CDARS ). CDARS provides FDIC insurance on deposits of up to \$50.0 million. Certificates of deposit mature every 28 to 91 days. Our other types of short-term investments generally have interest reset dates of every 3 to 7 days. These financial instruments may be subject to interest rate risk through lost income should interest rates increase during their limited term to maturity or resetting of interest rates and thus may limit our ability to invest in higher interest investments.

As of August 1, 2009, there was no long-term debt outstanding. Future borrowings, if any, would bear interest at negotiated rates and would be subject to interest rate risk. Because we have no outstanding debt, we do not believe that a hypothetical adverse change of 1% in interest rates would have a material effect on our financial position.

**Item 4. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

We, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, performed an evaluation of our disclosure controls and procedures, as such term is defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded, as of the end of the period covered by this report, that such disclosure controls and procedures were effective.

**Changes in Internal Control over Financial Reporting**

No change was made in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are involved in various legal proceedings that are incidental to the conduct of our business. We estimate the range of liability related to pending litigation where the amount of the range of loss can be estimated. We record our best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss, we record the most likely estimated liability related to the claim. In the opinion of management, the amount of any potential liability with respect to current legal proceedings will not be material to our results of operations or financial condition. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise the estimates as needed. Revisions in our estimates and potential liability could materially impact our results of operations and financial condition.

**Item 1A. Risk Factors.**

The following risk factors supplement DSW's risk factors set forth in Part I, Item 1A of our last Annual Report on Form 10-K for the fiscal year ended January 31, 2009 and update the risk factors set forth in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarter ended May 2, 2009

***Filene's Basement ( liquidating Filene's Basement ) has filed for bankruptcy protection. Liquidating Filene's Basement owes us approximately \$0.6 million as of August 1, 2009 and we may not be able to collect this amount. Further, we have signed an agreement with SYL LLC, who purchased certain assets of Filene's Basement, to provide transition services for up to one year, after which time we may not be able to allocate Filene's Basement a portion of our expenses, which will lead to increased expense to us.***

On May 4, 2009, Filene's Basement ( liquidating Filene's Basement ) filed for bankruptcy protection. On June 18, 2009, SYL LLC acquired real property leases relating to 23 Filene's Basement store locations and its distribution center, fixed assets and equipment at these locations, inventory at all Filene's Basement locations, certain contracts (including the shoe supply contract with DSW), certain intellectual property and certain other related assets. SYL LLC also assumed certain obligations of Filene's Basement under acquired contracts and real property leases. In connection with the sale of assets to SYL LLC, we entered into a Transition Services Agreement whereby we agreed to provide transition services to Filene's Basement for up to one year in exchange for a monthly payment.

As of August 1, 2009, liquidating Filene's Basement owes us approximately \$0.6 million for services rendered by us prior to the filing of bankruptcy. We have fully reserved this receivable. We plan on submitting a proof of claim in the bankruptcy proceeding seeking payment in full for all amounts owed to us. However, there is no assurance that we will be able to collect all or any of the amounts owed to us.

Further, after the end of the transition period, we will no longer be able to allocate a portion of our expenses to Filene's Basement, which will lead to increased expenses for us. The amount of this increased expense could be material and may have a negative impact on our results of operations and financial position.

***RVI has a long-term lease and DSW has agreed to pay two-thirds of the expense related to the lease.***

RVI is party to a lease for an office facility in Columbus, Ohio (the Premises ) as of September 2003. In April 2005, RVI sublet the Premises to a third-party at a rent that was lower than the rent charged to RVI under the lease. However, RVI remains liable under the lease. DSW, through the master separation agreement entered into with RVI at the time of DSW's IPO, agreed to pay two-thirds of any net expense and receive two-thirds of any net profit from the lease. In fiscal 2009, DSW expects to pay \$0.5 million related to this agreement. In the event the third-party subtenant defaults under the sublease or vacates the premises, the amount of this increased expense could be material and may have a negative impact on our results of operations and financial position.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(a) Recent sales of unregistered securities. Not applicable.

(b) Use of Proceeds. Not applicable.

(c) Purchases of equity securities by the issuer and affiliated purchasers.

DSW made no purchases of its Common Shares during the three months ended August 1, 2009.



**Table of Contents**

We do not anticipate paying cash dividends on our Common Shares in the foreseeable future. Presently, we expect that all of our future earnings will be retained for development of our business. The payment of any future dividends will be at the discretion of our board of directors and will depend upon, among other things, future earnings, operations, capital requirements, our general financial condition and general business conditions. Our credit facility restricts the payment of dividends by us or our subsidiaries, other than dividends paid in our stock or paid to another affiliate, and cash dividends can only be paid to Retail Ventures by us up to the aggregate amount of \$5.0 million, less the amount of any loan advances made to Retail Ventures by us or our subsidiaries.

**Item 3. Defaults Upon Senior Securities.** None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

We held our 2009 Annual Meeting of Shareholders on May 21, 2009. Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities Exchange Act of 1934. Matters discussed or voted on at the annual meeting were (i) the election of four Class II directors; (ii) the approval of the Company's 2005 Equity Incentive Plan; and (iii) the approval of the Company's 2005 Cash Incentive Plan. The following people continue to serve as Class I Directors until the annual meeting in 2011 or until their successors are duly elected and qualified: Carolee Friedlander, Harvey L. Sonnenberg, Allan J. Tanenbaum and Heywood Wilansky. The following people continue to serve as Class III Directors until the annual meeting in 2010 or until their successors are duly elected and qualified: Elaine J. Eisenman, Joanna T. Lau and Roger S. Markfield. The following persons were elected as Class II members of the Board of Directors to serve a three year term until the annual meeting in 2012 or until their successors are duly elected and qualified: Jay L. Schottenstein, Michael R. MacDonald, Philip B. Miller and James D. Robbins. Each person received the number of votes for or the number of votes with authority withheld indicated below. The 2005 Equity Incentive Plan and 2005 Cash Incentive Plan, excluding broker non-votes, received the number of votes with authority for or votes against indicated below.

|                            |             | Number of Shares      |           |         |
|----------------------------|-------------|-----------------------|-----------|---------|
|                            | FOR         | WITHHOLD<br>AUTHORITY | AGAINST   | ABSTAIN |
| Class II Directors:        |             |                       |           |         |
| Jay L. Schottenstein       | 235,127,192 | 1,026,375             |           |         |
| Michael R. MacDonald       | 235,645,686 | 507,881               |           |         |
| Philip B. Miller           | 235,729,476 | 424,091               |           |         |
| James D. Robbins           | 235,526,085 | 627,482               |           |         |
| 2005 Equity Incentive Plan | 227,789,691 |                       | 6,169,022 | 9,100   |
| 2005 Cash Incentive Plan   | 233,121,823 |                       | 840,958   | 5,032   |

**Item 5. Other Information.** None.

**Item 6. Exhibits.** See Index to Exhibits on page 26.

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**DSW INC.**

(Registrant)

Date: September 3, 2009

By: /s/ Douglas J. Probst

Douglas J. Probst

Executive Vice President and Chief Financial  
Officer

(principal financial officer and duly authorized  
officer)



**Table of Contents**

**INDEX TO EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 31.1                      | Rule 13a-14(a)/15d-14(a)<br>Certification of Chief Executive Officer |
| 31.2                      | Rule 13a-14(a)/15d-14(a)<br>Certification of Chief Financial Officer |
| 32.1                      | Section 1350 Certification of<br>Chief Executive Officer             |
| 32.2                      | Section 1350 Certification of<br>Chief Financial Officer             |