

DSW Inc.
Form 10-Q
December 02, 2015
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 October 31, 2015

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.

Large
Accelerated Filer
Accelerated Filer

Non-accelerated
Filer
(Do not check if
smaller reporting
company)
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

The number of outstanding Class A Common Shares, without par value, as of November 27, 2015 was 78,877,315 and Class B Common Shares, without par value, as of November 27, 2015 was 7,732,807.

DSW INC.
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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

DSW INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands, except per share amounts)

(unaudited)

	Three months ended		Nine months ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Net sales	\$665,520	\$669,872	\$1,948,212	\$1,855,915
Cost of sales	(466,554)	(451,315)	(1,344,886)	(1,277,449)
Operating expenses	(135,637)	(138,720)	(406,844)	(384,056)
Operating profit	63,329	79,837	196,482	194,410
Interest expense	(49)	(44)	(127)	(131)
Interest income	1,001	781	2,751	2,518
Interest income, net	952	737	2,624	2,387
Non-operating (expense) income	(107)	—	3,198	—
Income from continuing operations before income taxes and income (loss) from Town Shoes	64,174	80,574	202,304	196,797
Income tax provision	(25,575)	(32,069)	(77,157)	(76,532)
Income (loss) from Town Shoes	696	1,049	(876)	1,898
Income from continuing operations	39,295	49,554	124,271	122,163
Income from discontinued operations, net of tax	—	—	—	358
Net income	\$39,295	\$49,554	\$124,271	\$122,521
Basic and diluted earnings per share:				
Basic earnings per share from continuing operations	\$0.45	\$0.56	\$1.41	\$1.36
Diluted earnings per share from continuing operations	\$0.44	\$0.55	\$1.39	\$1.34
Basic earnings per share from discontinued operations	—	—	—	0.00
Diluted earnings per share from discontinued operations	—	—	—	0.00
Basic earnings per share	\$0.45	\$0.56	\$1.41	\$1.36
Diluted earnings per share	\$0.44	\$0.55	\$1.39	\$1.35
Shares used in per share calculations:				
Basic shares	87,493	88,781	88,244	89,909
Diluted shares	88,369	89,810	89,229	91,014
Other comprehensive income (loss):				
Foreign currency translation	\$28	\$(1,072)	\$(6,810)	\$(1,161)
Unrealized net gain (loss) on available-for-sale securities (net of taxes of \$36, \$0, \$42 and \$0, respectively)	44	—	(267)	—
Total comprehensive income	\$39,367	\$48,482	\$117,194	\$121,360

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

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DSW INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	October 31, 2015	January 31, 2015	November 1, 2014
ASSETS			
Cash and equivalents	\$90,019	\$59,171	\$96,394
Short-term investments	—	171,201	128,381
Accounts receivable, net	18,211	24,400	26,528
Accounts receivable from related parties	53	7	82
Inventories	521,243	450,836	486,260
Prepaid expenses and other current assets	22,209	43,108	26,566
Deferred income taxes	25,365	19,747	23,486
Total current assets	677,100	768,470	787,697
Property and equipment, net	364,253	337,903	338,227
Long-term investments	306,483	216,756	202,259
Goodwill	25,899	25,899	25,899
Deferred income taxes	8,666	11,332	14,643
Prepaid rent to related parties	902	794	758
Investment in Town Shoes	21,229	25,887	24,838
Note receivable from Town Shoes	45,930	43,304	47,819
Other assets	7,566	7,898	8,092
Total assets	\$1,458,028	\$1,438,243	\$1,450,232
LIABILITIES AND SHAREHOLDERS' EQUITY			
Accounts payable	\$168,537	\$169,518	\$185,181
Accounts payable to related parties	629	1,092	750
Accrued expenses	117,895	113,180	125,885
Total current liabilities	287,061	283,790	311,816
Non-current liabilities	142,834	143,333	142,540
Commitments and contingencies	—	—	—
Shareholders' equity:			
Common shares paid in capital, no par value; 250,000 Class A Common Shares authorized; 84,053, 83,702 and 83,484 issued, respectively; 78,877, 80,666 and 80,448 outstanding, respectively; 100,000 Class B Common Shares authorized, 7,733, issued and outstanding	924,115	908,679	902,440
Preferred Shares, no par value; 100,000 authorized; no shares issued or outstanding	—	—	—
Treasury shares, at cost, 5,176, 3,036 and 3,036	(150,000)	(86,938)	(86,938)
Retained earnings	292,542	220,826	206,528
Basis difference related to acquisition of commonly controlled entity	(24,993)	(24,993)	(24,993)
Accumulated other comprehensive loss	(13,531)	(6,454)	(1,161)
Total shareholders' equity	1,028,133	1,011,120	995,876

Total liabilities and shareholders' equity	\$1,458,028	\$1,438,243	\$1,450,232
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The accompanying Notes are an integral part of the Condensed Consolidated Financial Statements.

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

	Number of Shares					Retained earnings	Basis difference related to acquisition of commonly controlled entity	Accumulated other comprehensive loss	Total
	Class A Common Shares	Class B Common Shares	Treasury Shares	Common shares paid in capital	Treasury shares				
Balance, February 1, 2014	83,033	7,733	38	\$890,698	\$(1,600)	\$134,439	\$(24,993)	\$—	\$998,544
Net income	—	—	—	—	—	122,521	—	—	122,521
Stock-based compensation expense, before related tax effects	—	—	—	7,261	—	—	—	—	7,261
Stock units granted	49	—	—	1,205	—	—	—	—	1,205
Exercise of stock options	290	—	—	3,280	—	—	—	—	3,280
Vesting of restricted stock units, net of settlement of taxes	74	—	—	(1,649)	—	—	—	—	(1,649)
Repurchase of Class A Common Shares	(2,998)	—	2,998	—	(85,338)	—	—	—	(85,338)
Excess tax benefits related to stock-based compensation	—	—	—	1,645	—	—	—	—	1,645
Foreign currency translation	—	—	—	—	—	—	—	(1,161)	(1,161)
Dividends paid (\$0.5625 per share)	—	—	—	—	—	(50,432)	—	—	(50,432)
Balance, November 1, 2014	80,448	7,733	3,036	\$902,440	\$(86,938)	\$206,528	\$(24,993)	\$(1,161)	\$995,876
Balance, January 31, 2015	80,666	7,733	3,036	\$908,679	\$(86,938)	\$220,826	\$(24,993)	\$(6,454)	\$1,011,120
Net income	—	—	—	—	—	124,271	—	—	124,271
Stock-based compensation expense, before related tax effects	—	—	—	9,768	—	—	—	—	9,768
Stock units granted	34	—	—	969	—	—	—	—	969
Exercise of stock options	266	—	—	3,453	—	—	—	—	3,453

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Vesting of restricted stock units, net of settlement of taxes	51	—	—	(1,271))—	—	—	—	(1,271))	
Repurchase of Class A Common Shares	(2,140)	)—	2,140	—	(63,062)	)—	—	—	(63,062))	
Excess tax benefits related to stock-based compensation	—	—	—	2,517	—	—	—	—	2,517		
Foreign currency translation	—	—	—	—	—	—	—	(6,810))	(6,810))
Unrealized net loss on available-for-sale securities (net of taxes of \$42)	—	—	—	—	—	—	—	(267))	(267))
Dividends paid (\$0.60 per share)	—	—	—	—	—	(52,555)	)—	—	(52,555))	
Balance, October 31, 2015	78,877	7,733	5,176	\$924,115	\$(150,000)	\$292,542	\$(24,993)	\$(13,531)	)	\$1,028,133

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

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

	Nine months ended	
	October 31, 2015	November 1, 2014
Cash flows from operating activities:		
Net income	\$ 124,271	\$ 122,521
Less: Income from discontinued operations, net of tax	—	358
Income from continuing operations	\$ 124,271	\$ 122,163
Adjustments to reconcile net income to net cash and equivalents provided by operating activities from continuing operations:		
Depreciation and amortization	54,837	50,762
Stock-based compensation expense	10,737	8,466
Deferred income taxes	(2,953	) (8,412
(Income) loss from Town Shoes	876	(1,898
Loss on disposal of long-lived assets	560	821
Impairment of long-lived assets	418	4,975
Amortization of investment discounts and premiums	4,533	7,413
Excess tax benefits related to stock-based compensation	(2,517	) (1,645
Gain on foreign currency exchange rate	(3,267) —
Change in working capital, assets and liabilities:		
Accounts receivable, net	6,143	36
Inventories	(70,407	) (88,492
Prepaid expenses and other current assets	14,010	7,189
Accounts payable	(4,249	) 15,340
Accrued expenses	7,576	10,244
Other	4,747	4,529
Net cash and equivalents provided by operating activities from continuing operations	\$ 145,315	\$ 131,491
Cash flows from investing activities:		
Cash paid for property and equipment	(79,852	) (72,399
Purchases of available-for-sale investments	(242,092	) (4,805
Purchases of held-to-maturity investments	—	(78,622
Sales of available-for-sale investments	312,909	26,855
Maturities of held-to-maturity investments	—	185,805
Decrease in restricted cash	6,780	102
Equity investment in Town Shoes	203	(25,322
Purchase of note receivable from Town Shoes	(4,764	) (46,596
Net cash and equivalents used in investing activities from continuing operations	\$(6,816	) \$(14,982
Cash flows from financing activities:		
Proceeds from exercise of stock options	3,453	3,280
Cash paid for income taxes for shares withheld	(1,271	) (1,649
Cash paid for treasury shares	(63,062	) (85,338
Dividends paid	(52,555) (50,432

Excess tax benefits related to stock-based compensation	2,517	1,645
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	Nine months ended	
	October 31, 2015	November 1, 2014
Net cash and equivalents used in financing activities from continuing operations	\$(110,918)	\$(132,494)
Cash flows from discontinued operations:		
Operating activities	\$—	\$358
Net increase in cash and equivalents from discontinued operations	\$—	\$358
Effect of exchange rate changes on cash balances	\$3,267	\$—
Net increase (decrease) in cash and equivalents from continuing operations	27,581	(15,985)
Cash and equivalents, beginning of period	59,171	112,021
Cash and equivalents, end of period	\$90,019	\$96,394
Supplemental disclosures of cash flow information:		
Cash paid during the period for income taxes	\$69,144	\$62,554
Proceeds from construction and tenant allowances	\$18,855	\$13,599
Non-cash operating, investing and financing activities:		
Balance of accounts payable and accrued expenses due to property and equipment purchases	\$7,640	\$9,116

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

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. BUSINESS OPERATIONS AND BASIS OF PRESENTATION

Business Operations- DSW Inc. and its wholly owned subsidiaries are herein referred to collectively as DSW Inc. or the “Company”. DSW refers to the DSW segment, which includes DSW stores and dsw.com. DSW Class A Common Shares are listed on the New York Stock Exchange under the ticker symbol “DSW”. DSW Class B Common Shares are not listed on a stock exchange but are exchangeable for Class A Common Shares at the election of the shareholder.

DSW Inc. has two reportable segments: the DSW segment, which includes DSW stores and dsw.com, and the Affiliated Business Group (“ABG”) segment. DSW offers a wide assortment of brand name dress, casual and athletic footwear and accessories for women, men and kids. As of October 31, 2015, DSW operated a total of 465 stores located in 42 states, the District of Columbia and Puerto Rico, and dsw.com. During the nine months ended October 31, 2015, DSW opened 36 new DSW stores and closed two DSW stores.

DSW Inc., through its ABG segment, also partners with three other retailers to help build and optimize their footwear businesses. As of October 31, 2015, ABG supplied merchandise to 273 Stein Mart stores and Steinmart.com, 102 Gordmans stores and Gordmans.com, and one Frugal Fannie’s store. During the nine months ended October 31, 2015, ABG added 13 new shoe departments and ceased operations in 8 shoe departments, which includes the closure of all four Yellow Box test stores. The closure of these Yellow Box stores resulted in store closing expenses (excluding asset impairment) of \$0.9 million for the nine months ended October 31, 2015.

DSW Inc. also has an equity investment in Town Shoes Limited (“Town Shoes”). Town Shoes is the market leader in branded footwear in Canada. As of October 31, 2015, Town Shoes operated 173 locations across Canada primarily under The Shoe Company, Shoe Warehouse and Town Shoes banners, an e-commerce site, as well as 13 DSW Designer Shoe Warehouse stores, operated under a licensing agreement. See Note 4 for further disclosure on the licensing agreement.

Basis of Presentation- The accompanying unaudited condensed consolidated interim financial statements should be read in conjunction with DSW Inc.’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 26, 2015 (the “2014 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 condensed consolidated financial position, results of operations and cash flows for the periods presented. The condensed consolidated interim financial statements include the accounts of DSW Inc. and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. All amounts are in United States dollars (“USD”), unless otherwise noted.

2. INVESTMENT IN TOWN SHOES

On May 12, 2014, DSW Inc. acquired a 49.2% interest in Town Shoes, the largest branded footwear and accessories retailer in Canada, for \$75.1 million Canadian dollars (“CAD”) (\$68.9 million USD). As of October 31, 2015, DSW Inc.’s ownership interest is 46.3%, and the dilution of the Company’s ownership is due to Town Shoes’ employee exercises of stock options. DSW Inc.’s stake provides 50% voting control and board representation equal to the co-investor’s.

Additionally, the Town Shoe co-investor holds the option to sell the remaining portion of the company in fiscal 2017 to DSW Inc., and for the subsequent two years. DSW Inc. holds the option to purchase the remaining portion of the company in fiscal 2018, and for the subsequent two years, if the Town Shoe co-investor has not exercised their put option. DSW Inc. purchased \$100 million CAD during the first quarter of fiscal 2015 (approximately \$79 million

USD at purchase date) to take advantage of the strength of the dollar and in anticipation of funding the future purchase of the remaining interest in Town Shoes. The funds are also available to fund other business opportunities or return to U.S. operations, if needed. As this was a cash transaction, the gains or losses related to the purchase of the CAD are run through the statement of operations. During the first quarter of fiscal 2015, the Company recorded \$3.3 million in foreign currency exchange gains related to the purchase of CAD within non-operating income. The Company invested the CAD in available-for-sale securities in the second quarter of fiscal 2015. As this was a non-cash transaction, the foreign exchange gain or loss is run through the consolidated balance sheet. During the nine months ended October 31, 2015, the foreign currency exchange loss of \$5.9 million is recorded within other comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

A description of DSW's significant accounting policies is included in DSW's 2014 Annual Report. The following policies represent new or updates to significant accounting policies.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

ABG Sales and Revenue Recognition- ABG supplies footwear, under supply arrangements, to three other retailers. The Company closed all four test stores under the Yellow Box banner during fiscal 2015. DSW Inc. follows Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition, in recognizing revenue for its affiliated business processes, specifically the principal/agent guidance in ASC 605-45. Sales for these affiliated businesses are net of returns through period end and exclude sales tax, and are included in net sales. Pursuant to the supply agreements between the Company and the ABG retailers (Stein Mart, Frugal Fannie's and Gordmans), the Company is the exclusive supplier of shoes, both in-store and online, at the ABG retailers. The Company assumes the risks and rewards of ownership for product at all in-store locations and online, including risk of loss for delivery, returns, shrink up to a certain percentage, and loss of inventory value. Furthermore, the Company is responsible for the footwear assortment, inventory fulfillment, and pricing at all locations and online. As the principal, the Company owns the merchandise and the fixtures, records sales of merchandise, net of returns and excluding sales tax at the point of sale to the end customer. As the agent, the retailers provide the sales associates and retail space. The Company pays a percentage of net sales as rent, which is included in cost of sales as occupancy expense.

Non-operating (Expense) Income- Non-operating (expense) income includes remeasurement effects of foreign currency, as well as realized capital gains/losses related to the Company's investment portfolio.

Income Taxes- In accordance with ASC Topic 740, Income Taxes, interest and penalties related to unrecognized income tax benefits may either be classified as income tax expense or another appropriate expense classification in the consolidated statements of operations. Previously, the Company had elected to classify interest expense or income related to income tax liabilities, when applicable, as part of interest expense or income in its consolidated statements of operations rather than as part of income tax expense. The Company classified income tax penalties as part of operating expenses in its statements of operations. Beginning in the first quarter of fiscal 2015, the Company elected to reflect interest and penalties from income taxes through the income tax provision in its statement of operations. The policy is consistent with the policies elected by many of the Company's peers and thus will improve comparability of the Company's financial statements. The new policy is more consistent with the way in which the Company manages the settlement of uncertain income tax positions as one overall amount inclusive of interest and penalties. The Company also believes that interest and penalties related to unrecognized income tax benefits are costs of managing taxes payable and thus, it will provide more meaningful information to investors by including only interest expense from debt financing activities within interest expense.

This change in accounting policy was completed in accordance with ASC Topic 250, Accounting Changes and Error Corrections. Accordingly, the change in accounting policy has been applied retrospectively by adjusting the statement of operations for the prior periods presented. The change to historical periods was limited to classifications within the consolidated statements of operations and has no effect on net income or earnings per share.

	Three months ended November 1, 2014		Nine months ended November 1, 2014			
	(in thousands)					
	As previously reported	Effect of change	As adjusted	As previously reported	Effect of change	As adjusted
Operating expenses	\$ (138,860)	\$ 140	\$ (138,720)	\$ (384,208)	\$ 152	\$ (384,056)
Interest income, net	600	137	737	2,193	194	2,387
Income tax provision	(31,792)	(277)	(32,069)	(76,186)	(346)	(76,532)

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") released Accounting Standard Update ("ASU") 2014-09 on the recognition of revenue from contracts with customers that is designed to create greater comparability for financial statement users across industries and jurisdictions. Under the new standard, companies will recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The standard also will require enhanced disclosures and provide more comprehensive guidance for transactions such as service revenue and contract modifications. The standard will take effect for public companies for annual reporting periods beginning after December 15, 2017, including interim reporting periods. The Company is currently evaluating the transition methods and the impact of the standard on its financial statements and disclosures.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

In April 2015, the FASB and the IASB released ASU 2015-03, simplifying the presentation of debt issuance costs. Under the new standard, debt issuance costs related to a recognized debt liability will be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The standard will take effect for public companies for annual reporting periods beginning after December 15, 2015, including interim reporting periods. There is currently no impact to the Company; however, the Company will monitor the new standard and determine if it is likely to be impacted in the future.

In April 2015, the FASB released ASU 2015-05 to provide guidance to customers concerning whether a cloud computing arrangement includes a software license. Under this new standard, 1) if a cloud computing arrangement includes a software license, the software license element of the arrangement should be accounted for in a manner consistent with the acquisition of other software licenses, or 2) if the arrangement does not include a software license, the arrangement should be accounted for as a service contract. The standard will take effect for public companies for annual reporting periods beginning after December 15, 2015, including interim reporting periods. The Company intends to adopt the new standard when it takes effect and apply the new guidance prospectively.

4. RELATED PARTY TRANSACTIONS

Schottenstein Affiliates- As of October 31, 2015, the Schottenstein Affiliates (entities owned by or controlled by Jay L. Schottenstein, the executive chairman of the DSW Board of Directors, and members of his family) beneficially owned approximately 17% of outstanding DSW Common Shares representing approximately 49% of the combined voting power of outstanding DSW Common Shares. As of October 31, 2015, the Schottenstein Affiliates beneficially owned 7.0 million Class A Common Shares and 7.7 million Class B Common Shares.

The Company leases its fulfillment center and certain store locations owned by Schottenstein Affiliates and purchases services and products from Schottenstein Affiliates. Accounts receivable from and payable to affiliates principally result from commercial transactions or affiliate transactions and normally settle in the form of cash in 30 to 60 days. Related party balances are disclosed on the condensed consolidated balance sheets.

License Agreement with Town Shoes- DSW Shoe Warehouse, Inc., a wholly-owned subsidiary of DSW Inc., licenses use of its trade name and trademark, DSW Designer Shoe Warehouse, to its equity investee, Town Shoes, for a sales-based royalty. The license is exclusive and non-transferable for use in Canada. Town Shoes pays DSW Inc. a percentage of net sales from its Canadian DSW stores on a monthly basis. The Canadian DSW stores operate in a manner similar to DSW stores in the United States and are required to maintain the standards and specifications that DSW uses to operate its own stores. DSW classifies the royalty fee as net sales.

5. EARNINGS PER SHARE AND SHAREHOLDERS' EQUITY

Earnings per Share- Basic earnings per share is based on net income and a simple weighted average of common shares outstanding. Diluted earnings per share reflects the potential dilution of common shares adjusted for outstanding stock options, restricted stock units ("RSU") and performance-based restricted stock units ("PSU") calculated using the treasury stock method.

The following table is a reconciliation of the number of shares used in the calculation of diluted earnings per share computations for the periods presented:

Three months ended		Nine months ended	
October 31,	November 1,	October 31,	November 1,
2015	2014	2015	2014

(in thousands)

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Weighted average shares outstanding	87,493	88,781	88,244	89,909
Assumed exercise of dilutive stock options	640	846	751	915
Assumed exercise of dilutive RSUs and PSUs	236	183	234	190
Number of shares for computation of diluted earnings per share	88,369	89,810	89,229	91,014

Options, RSUs and PSUs- The number of potential common shares that were not included in the computation of dilutive earnings per share because the effect would be anti-dilutive was approximately 2.1 million and 1.3 million for the three months

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

ended October 31, 2015 and November 1, 2014, respectively, and 1.8 million and 1.3 million for the nine months ended October 31, 2015 and November 1, 2014, respectively.

Shareholders' Equity- During the three and nine months ended October 31, 2015, DSW repurchased 2.1 million Class A Common Shares at a cost of \$63.1 million, completing its prior \$150 million share repurchase authorization. On November 2, 2015, the Board of Directors approved an additional \$200 million share repurchase program. The share repurchase program may be suspended, modified or discontinued at any time, and the Company has no obligation to repurchase any amount of its common shares under the program. Shares will be repurchased on the open market at times and in amounts considered appropriate by the Company based on price and market conditions.

6. STOCK-BASED COMPENSATION

The DSW Inc. 2014 Long-Term Incentive Plan ("the 2014 Plan") provides for the issuance of equity awards to purchase up to 8.5 million DSW Common Shares. The Company began issuing shares under the 2014 Plan after the DSW Inc. 2005 Equity Incentive Plan expired in the second quarter of fiscal 2015. The 2014 Plan covers stock options, RSUs, PSUs and director stock units ("DSU"). Eligible recipients include key employees of DSW Inc. and affiliates, as well as directors. Options generally vest 20% per year on a cumulative basis. Options granted under the 2014 Plan generally remain exercisable for a period of ten years from the date of grant.

Stock-Based Compensation Expense- The following table summarizes stock-based compensation expense:

	Nine months ended	
	October 31, 2015	November 1, 2014
	(in thousands)	
Stock Options	\$5,165	\$4,606
Restricted Stock Units	1,986	1,724
Performance-Based Restricted Stock Units	2,617	931
Director Stock Units	969	1,205
Total	\$10,737	\$8,466

Stock Options, RSUs, PSUs and DSUs- The following table summarizes all stock-based compensation activity:

	Nine months ended			
	October 31, 2015			
	Stock Options	RSUs	PSUs	DSUs
	(in thousands)			
Outstanding, beginning of period	3,156	320	173	360
Granted	933	133	149	34
Options exercised/units vested	(265	) (84	) —	(93
Forfeited	(145	) (28	) (9) —
Outstanding, end of period	3,679	341	313	301
Exercisable, end of period	1,929	—	—	—

The following table summarizes the total compensation cost related to nonvested shares not yet recognized and the weighted average expense recognition period remaining (amounts in thousands):

Nine months ended
October 31, 2015

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	Stock Options	RSUs	PSUs
Unrecognized compensation cost	\$15,614	\$6,282	\$6,931
Weighted average expense recognition period	2.1 years	1.8 years	2.0 years

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

The following table illustrates the weighted average assumptions used in the Black-Scholes pricing model for DSW stock options granted in each of the periods presented:

Assumptions:	Nine months ended	
	October 31, 2015	November 1, 2014
Risk-free interest rate	1.4%	1.8%
Expected volatility of DSW Common Shares	37.9%	44.5%
Expected option term	5.1 years	5.4 years
Dividend yield	2.1%	2.3%
Other Data:		
Weighted average grant date fair value	\$10.09	\$11.82

Stock Appreciation Rights (“SARs”)- The 2014 Plan also covers the issuance of SARs. DSW Inc. entered into a SARs agreement with a non-employee on June 16, 2014, wherein DSW Inc. granted a total of 0.5 million SARs in two equal tranches with respect to DSW Class A Common Shares. On April 16, 2015, DSW Inc. provided notice of termination of the agreement with the non-employee resulting in an acceleration of the vesting of the SARs as outlined in the agreement, and the SARs remain exercisable until June 2016. DSW Inc. will value the SARs at fair value until the expiration or exercise date using a Black-Scholes model. During the three and nine months ended October 31, 2015, DSW recorded a benefit of \$2.5 million and a net benefit of \$0.9 million, respectively. As of October 31, 2015, the net liability was \$0.9 million.

The fair value of the SARs was estimated using the Black-Scholes pricing model with the following assumptions in each of the periods presented:

Assumptions:	October 31, 2015	January 31, 2015	November 1, 2014
Risk-free interest rate	0.2%	0.6%	0.7%
Expected volatility of DSW Class A Common Shares	29.8%	24.9%	26.7%
Expected term	0.6 years	2.3 years	2.6 years
Expected dividend yield	2.4%	2.3%	2.3%

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

7. INVESTMENTS

For the available-for-sale bonds and term notes, the carrying value plus any unrealized gains or losses equals the fair value. Held-to-maturity investments were primarily corporate bonds, municipal bonds and municipal term notes and were held at amortized cost, which approximated fair value. Long-term investments have maturities longer than one year but shorter than three years. As of October 31, 2015, DSW classifies all of its available-for-sale investments as long-term as management's intention is to hold these investments for longer than one year. The Company accounts for its purchases and sales of investments on the trade date of the investment. The following table discloses the major categories of the Company's investments as of the dates presented:

	Short-term investments			Long-term investments		
	October 31, 2015	January 31, 2015	November 1, 2014	October 31, 2015	January 31, 2015	November 1, 2014
	(in thousands)					
Available-for-sale securities:						
Carrying value	\$—	\$17,147	—	\$306,792	—	—
Unrealized gains included in accumulated other comprehensive income	—	—	—	207	—	—
Unrealized losses included in accumulated other comprehensive loss	—	—	—	(516)) —	—
Held-to-maturity securities:						
Amortized cost	—	154,054	\$128,381	—	\$216,756	\$202,259
Total investments	\$—	\$171,201	\$128,381	\$306,483	\$216,756	\$202,259
Gross holding gains on held-to-maturity securities	—	\$117	\$81	—	\$371	\$380
Gross holding losses on held-to-maturity securities	—	(50)	) (54)	—	(317)	) (284)
Fair value of securities	\$—	\$171,268	\$128,408	\$306,483	\$216,810	\$202,355

Change in Investment Classification- During the first quarter of fiscal 2015, the Company liquidated investments classified as held-to-maturity. As a result of the sale of held-to-maturity investments, the Company transferred its entire portfolio to the available-for-sale classification at fair value at the date of transfer. The Company determined that this transfer was a change in investment strategy. The unrealized holding gains or losses for the available-for-sale securities are reported in other comprehensive income.

8. 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, the Company 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.

• 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.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Financial Assets and Liabilities- The following table presents financial assets and liabilities at fair value as of the dates presented:

	October 31, 2015			January 31, 2015			November 1, 2014		
	Total	Level 1	Level 2	Total	Level 1	Level 2	Total	Level 1	Level 2
Financial assets: (in thousands)									
Cash and equivalents	\$90,019	\$90,019	—	\$59,171	\$59,171	—	\$96,394	\$96,394	—
Short-term investments (a)	—	—	—	171,268	—	\$171,268	128,408	—	\$128,408
Long-term investments (a)	306,483	4,392	\$302,091	216,810	—	216,810	202,355	—	202,355
Note receivable from Town Shoes (b)	45,930	—	45,930	43,304	—	43,304	47,819	—	47,819
Total financial assets	\$442,432	\$94,411	\$348,021	\$490,553	\$59,171	\$431,382	\$474,976	\$96,394	\$378,582
Financial liabilities:									
Stock appreciation rights (c)	\$891	—	\$891	—	—	—	—	—	—
Total financial liabilities	\$891	—	\$891	—	—	—	—	—	—

(a) Short-term and long-term investments primarily include available-for-sale and held-to maturity investments, which are valued using a market-based approach using level 2 inputs such as prices of similar assets in active markets.

(b) The shareholder note is valued based on similar assets in active markets.

(c) Stock appreciation rights are valued using the Black-Scholes model.

There are no financial assets or liabilities valued using level 3 inputs for the periods presented.

Non-Financial Assets- The Company periodically evaluates the carrying amount of its long-lived assets, primarily property and equipment, and finite-lived intangible assets when events and circumstances warrant such a review to ascertain if any assets have been impaired. For the nine months ended October 31, 2015, there was a full impairment related to one store in the ABG segment of \$0.4 million recorded in cost of sales where the future expected cash flows will not recover the carrying amount of its long-lived assets. For the nine months ended November 1, 2014, there were impairments of \$5.0 million recorded in cost of sales related to seven stores in the DSW and ABG segments, where the future expected cash flows will not recover the carrying amount of their long-lived assets. For these seven stores, DSW recorded a full impairment, net of related tenant allowances.

9. DEBT OBLIGATIONS

\$50 Million Secured Credit Facility- On August 2, 2013, the Company entered into a \$50 million secured revolving credit agreement (the "Credit Facility"), which has a term of five years and will expire on July 31, 2018. The Credit Facility may be increased by up to \$100 million upon the Company's request and the increase would be subject to lender availability, DSW Inc.'s financial condition and compliance with covenants. The Credit Facility is secured by a lien on substantially all of DSW Inc.'s personal property assets and its subsidiaries with certain exclusions and may be used to provide funds for general corporate purposes, to provide for ongoing working capital requirements and to make permitted acquisitions. The Credit Facility contains restrictive covenants relating to management and the operation of DSW Inc.'s business. These covenants, among other things, limit or restrict DSW Inc.'s ability to grant liens on its assets, limit its ability to incur additional indebtedness, limit its ability to enter into transactions with affiliates and limit its ability to merge or consolidate with another entity. The Credit Facility also requires that DSW Inc. meet the minimum cash and investments requirement of \$125 million, as defined in the Credit Facility. An additional covenant limits payments for capital expenditures to \$200 million in any fiscal year. The Company paid \$79.9 million for capital expenditures for the nine months ended October 31, 2015.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

As of October 31, 2015, January 31, 2015 and November 1, 2014, the Company had no outstanding borrowings under the Credit Facility and had availability under the facility of \$50.0 million. The Company also had no outstanding letters of credit under the Credit Facility as of October 31, 2015, January 31, 2015 and November 1, 2014.

\$50 Million Letter of Credit Agreement- Also on August 2, 2013, the Company entered into a letter of credit agreement (the "Letter of Credit Agreement"). The Letter of Credit Agreement provides for the issuance of letters of credit up to \$50 million, with a term of five years that will expire on August 2, 2018. The facility for the issuance of letters of credit is secured by a cash collateral account containing cash in an amount equal to 103% of the face amount of any letter of credit extension (105% for extensions denominated in foreign currency) and is used for general corporate purposes.

As of October 31, 2015, January 31, 2015 and November 1, 2014, the Company had \$4.2 million, \$9.3 million and \$4.5 million, respectively, in outstanding letters of credit under the Letter of Credit Agreement, and \$4.7 million, \$11.5 million and \$6.0 million, respectively, in restricted cash on deposit as collateral under the Letter of Credit Agreement. The restricted cash balance is recorded in prepaid expenses and other current assets on the condensed consolidated balance sheets.

10. PROPERTY AND EQUIPMENT, NET

The balance sheet caption "Property and equipment, net" was comprised of the following as of the dates presented:

	October 31, 2015	January 31, 2015	November 1, 2014
	(in thousands)		
Land	\$1,110	\$1,110	\$1,110
Furniture, fixtures and equipment	486,279	437,745	428,319
Buildings, building and leasehold improvements	379,176	353,283	345,562
Total property and equipment	866,565	792,138	774,991
Accumulated depreciation and amortization	(502,312)	(454,235)	(436,764)
Property and equipment, net	\$364,253	\$337,903	\$338,227

11. ACCRUED EXPENSES

The balance sheet caption "Accrued expenses" was comprised of the following as of the dates presented:

	October 31, 2015	January 31, 2015	November 1, 2014
	(in thousands)		
Gift cards and merchandise credits	\$34,016	\$40,313	\$31,859
Compensation	14,712	11,317	14,199
Taxes	21,122	16,798	31,406
Customer loyalty program	13,455	14,788	15,718
Other ⁽¹⁾	34,590	29,964	32,703
Total accrued expenses	\$117,895	\$113,180	\$125,885

(1) Other is comprised of deferred revenue, guarantees, sales return allowance, stock appreciation rights (as of October 31, 2015) and various other accrued expenses, including advertising expenses, professional fees and rent.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

12. NON-CURRENT LIABILITIES

The balance sheet caption "Non-current liabilities" was comprised of the following as of the dates presented:

	October 31, 2015	January 31, 2015	November 1, 2014
	(in thousands)		
Construction and tenant allowances	\$88,257	\$85,244	\$85,363
Deferred rent	38,056	38,021	38,449
Other ⁽¹⁾	16,521	20,068	18,728
Total non-current liabilities	\$142,834	\$143,333	\$142,540

(1) Other is comprised of a reserve for a lease of an office facility assumed in the merger with Retail Ventures, Inc. ("RVI"), income tax reserves and deferred compensation. During the first quarter of fiscal 2015, the Company adjusted its assumptions related to the reserve for a lease of an office facility for future real estate taxes, sublease rental payments and executory costs. As of October 31, 2015, the accrual related to the office facility was \$8.6 million.

13. SEGMENT REPORTING

The reportable segments are the DSW segment, which includes DSW stores and dsw.com, and the ABG segment. The Company has identified such segments based on internal management reporting and 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 and its territories. The goodwill balance of \$25.9 million as of October 31, 2015, January 31, 2015 and November 1, 2014 is recorded in the DSW segment. In order to reconcile to the condensed consolidated financial statements, the Company includes Other, which consists of assets, liabilities and expenses of the former RVI (see Note 15), the investment in Town Shoes, cash and assets of DSW's Canadian subsidiary (see Note 2).

	DSW segment	ABG segment	Other	Total
	(in thousands)			
Three months ended October 31, 2015				
Net sales	\$628,778	\$36,742	—	\$665,520
Gross profit	190,903	8,063	—	198,966
Capital expenditures	27,990	371	—	28,361
Three months ended November 1, 2014				
Net sales	\$632,774	\$37,098	—	\$669,872
Gross profit	211,863	6,694	—	218,557
Capital expenditures	26,622	1,147	—	27,769
Nine months ended October 31, 2015				
Net sales	\$1,833,572	\$114,640	—	\$1,948,212
Gross profit	579,703	23,623	—	603,326
Capital expenditures	81,563	589	—	82,152
Nine months ended November 1, 2014				
Net sales	\$1,745,454	\$110,461	—	\$1,855,915

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Gross profit	556,194	22,272	—	578,466
Capital expenditures	73,404	2,501	—	75,905
Total Assets				
As of October 31, 2015	\$1,196,332	\$117,772	\$143,924	\$1,458,028
As of January 31, 2015	1,263,577	104,897	69,769	1,438,243
As of November 1, 2014	1,279,852	97,346	73,034	1,450,232

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

14. 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 effective tax rate reflects the impact of federal, state and local, and foreign taxes, as well as tax on the income or loss from Town Shoes. The effective tax rate for the three and nine months ended October 31, 2015 was 39.4% and 38.3%, respectively. The effective tax rate for the three and nine months ended November 1, 2014 was 39.3% and 38.5%, respectively.

15. COMMITMENTS AND CONTINGENCIES

Legal Proceedings- The Company is involved in various legal proceedings that are incidental to the conduct of its business. Although it is not possible to predict with certainty the eventual outcome of any litigation, in the opinion of management, the amount of any potential liability with respect to current legal proceedings will not be material to 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.

Merger with Retail Ventures, Inc. ("the Merger")- On May 26, 2011, RVI merged with and into DSW MS LLC ("Merger Sub"), with Merger Sub surviving the Merger and continuing as a wholly owned subsidiary of DSW Inc. Upon the closing of the Merger, each outstanding RVI common share was converted into 0.435 DSW Class A Common Shares, unless the holder of each outstanding RVI common share properly and timely elected to receive a like number of DSW Class B Common Shares.

As of the effective time of the Merger, a subsidiary of DSW Inc. assumed the obligations under RVI's guarantees related to discontinued operations. DSW Inc. may become subject to various risks related to guarantees and in certain circumstances may be responsible for certain other liabilities related to these discontinued operations. In the first quarter of fiscal 2015, the Company recorded a \$2.0 million benefit from the final distribution from the bankruptcy debtor's estates related to Filene's Basement's bankruptcy in 2011.

Filene's Basement- Following the Merger, a subsidiary of DSW Inc., Merger Sub, assumed RVI's obligations under lease guarantees for three Filene's Basement retail store locations for leases assumed by Syms Corp in its purchase of Filene's Basement in fiscal 2009. The remaining guarantee is described in more detail below:

Union Square, NY- RVI guaranteed Filene's Basement's obligations for the Union Square location when RVI owned Filene's Basement, and the landlord at the Union Square location brought a lawsuit against Merger Sub in the Supreme Court of the State of New York seeking payment under a guarantee of the lease (the lease is scheduled to expire in 2024). On February 27, 2015, the parties jointly entered into a Stipulation and Settlement Agreement that provides for the settlement and release of the guaranty litigation and certain claims arising from the Filene's/Syms bankruptcy. The settlement approximated the accrual.

Contractual Obligations- As of October 31, 2015, the Company has 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. The Company's obligations under these commitments were \$1.2 million as of October 31, 2015. In addition, the Company has signed lease agreements for 23 new DSW store locations, expected to be opened in fiscal 2015 and 2016 with total annual rent of \$6.2 million. In connection with the new lease agreements, the Company will receive a total of \$8.5 million of construction and tenant allowance reimbursements for expenditures at these locations.

16. SUBSEQUENT EVENTS

Dividends- On November 24, 2015, DSW Inc.'s Board of Directors declared a quarterly cash dividend payment of \$0.20 per share. The dividend will be paid on December 31, 2015 to shareholders of record at the close of business on December 18, 2015.

Share Repurchase Program- On November 2, 2015, the Board of Directors authorized the repurchase of an additional \$200 million of DSW Common Shares under the Company's share repurchase program.

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

All references to “we,” “us,” “our,” or the “Company” in this Quarterly Report on Form 10-Q mean DSW Inc. and its wholly owned subsidiaries. DSW refers to the DSW segment, which includes DSW stores and dsw.com. DSW Class A Common Shares are listed for trading under the ticker symbol “DSW” on the New York Stock Exchange (“NYSE”).

Company Overview

DSW is the destination for fabulous brands at a great value every single day. With a breathtaking assortment of shoes, handbags and accessories for women and men in 465 stores nationwide and on dsw.com, DSW strives to delight customers with finding the perfect shoe at an incredible price. Our DSW stores average approximately 21,000 square feet and carry approximately 22,000 pairs of shoes. In addition, DSW Rewards means shopping comes with perks; members earn points towards certificates every time they purchase. We believe this combination of assortment, convenience and value differentiates us from our competitors and appeals to consumers from a broad range of socioeconomic and demographic backgrounds.

As a segment of DSW Inc., the Affiliated Business Group (“ABG”) partners with multi-category retailers to develop strategies and business models for targeted shoe assortments. ABG provides service to 376 store locations and e-commerce channels through leased partnerships with Stein Mart, Gordmans and Frugal Fannies.

DSW Inc. also has an equity investment in Town Shoes Limited (“Town Shoes”). Town Shoes is the market leader in branded footwear in Canada. As of October 31, 2015, Town Shoes operated 173 locations across Canada, primarily under The Shoe Company, Shoe Warehouse and Town Shoes banners, as well as an e-commerce site. In May 2014, DSW Inc. entered into a licensing agreement with Town Shoes, which allows Town Shoes to use the DSW Designer Shoe Warehouse tradename for their new larger concept Canadian stores. As of October 31, 2015, there are 13 DSW Designer Shoe Warehouse stores in Canada.

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. Such forward-looking statements can be identified by the use of forward-looking words such as “outlook,” “believes,” “expects,” “potential,” “continues,” “may,” “should,” “seeks,” “approximately,” “predicts,” “intends,” “plans,” “estimates,” “anticipates” or the negative of those words or other comparable words. Any forward-looking statements contained in this Quarterly Report on Form 10-Q are based upon current plans, estimates, 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 the DSW Form 10-K filed on March 26, 2015, under “Part II, Item 1A. Risk Factors,” in the DSW Form 10-Q's filed on June 4, 2015 and September 3, 2015, and included in this Form 10-Q, some important factors that could cause actual results, performance or achievements to differ materially from those discussed in forward-looking statements include, but are not limited to, the following:

- our success in executing our omni-channel strategy;
- our success in opening and operating new stores on a timely and profitable basis;
- maintaining strong relationships with our vendors;
- our ability to anticipate and respond to fashion trends;

- disruption of our distribution and/or fulfillment operations;
- continuation of supply agreements and the financial condition of our affiliated business partners;
- fluctuation of our comparable sales and quarterly financial performance;
- risks related to our information systems and data;
- failure to retain our key executives or attract qualified new personnel;
- our competitiveness with respect to style, price, brand availability and customer service;
- our reliance on our DSW Rewards program and marketing to drive traffic, sales and customer loyalty;
- uncertain general economic conditions;
- our reliance on foreign sources for merchandise and risks inherent to international trade;
- risks related to our handling of sensitive and confidential data;
- risks related to leases of our properties;
- risks related to the realization of benefits related to our equity interest in Town Shoes, a leading branded shoe retailer in Canada;

foreign currency exchange risk; and
risks related to our cash and investments.

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 management 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, we undertake 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.

Results of Operations

The following table includes selected components of our results of operations, expressed as percentages of net sales:

	Three months ended		Nine months ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	(70.1)	(67.4)	(69.0)	(68.8)
Gross profit	29.9	32.6	31.0	31.2
Operating expenses	(20.4)	(20.7)	(20.9)	(20.7)
Operating profit	9.5	11.9	10.1	10.5
Interest income, net	0.1	0.1	0.1	0.1
Non-operating (expense) income	0.0	—	0.2	—
Income from continuing operations before income taxes and income (loss) from Town Shoes	9.6	12.0	10.4	10.6
Income tax provision	(3.8)	(4.8)	(4.0)	(4.1)
Income (loss) from Town Shoes	0.1	0.2	—	0.1
Income from continuing operations	5.9	7.4	6.4	6.6
Income from discontinued operations, net of tax	—	—	—	0.0
Net income	5.9%	7.4%	6.4%	6.6%

Overview. Our net income for the nine months ended October 31, 2015 was \$124.3 million, or \$1.39 per share. This compares against last year's net income of \$122.5 million, or \$1.35 per share. During the nine months ended October 31, 2015, total net sales increased 5.0% to \$1.95 billion, driven by a 0.9% increase in comparable sales and the net increase of 34 stores over last year.

We continue to focus on being customer-centric in the way we operate by adding technologies and making organizational changes to provide a seamless and relevant shopping experience to our customers. During the third quarter, we implemented Buy Online Pickup in Store and Buy Online Ship to Store. We continue to leverage our strengths, enhance our offerings to the customer, and create meaningful differentiation from our competitors. We have implemented incremental promotional measures to improve sales trends, and will be taking a more aggressive approach to pricing action and marketing to encourage our customers to visit our stores and our .com site.

THREE AND NINE MONTHS ENDED OCTOBER 31, 2015 COMPARED TO THREE AND NINE MONTHS ENDED NOVEMBER 1, 2014

Net Sales. Net sales for the third quarter of fiscal 2015 decreased 0.6% compared to the third quarter of fiscal 2014. Net sales for the nine months ended October 31, 2015 increased 5.0% compared to the nine months ended November 1, 2014. The following tables summarize the net change in our net sales:

	Three months ended October 31, 2015	Nine months ended October 31, 2015
	(in millions)	
Net sales for the same period last year	\$669.9	\$1,855.9
(Decrease) increase in comparable sales	(24.9	) 15.3
Net increase from non-comparable and closed store sales	20.5	77.0
Net sales for the current period	\$665.5	\$1,948.2

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

	Three months ended		Nine months ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
	(in thousands)			
DSW segment	\$628,778	\$632,774	\$1,833,572	\$1,745,454
ABG segment	36,742	37,098	114,640	110,461
Total DSW Inc.	\$665,520	\$669,872	\$1,948,212	\$1,855,915

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

	Three months ended		Nine months ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
DSW segment	(3.9)%	2.8%	0.8%	(0.1)%
ABG segment	(3.0)%	0.3%	1.0%	1.2%
Total DSW Inc.	(3.9)%	2.6%	0.9%	(0.1)%

Our decrease in total net sales for the three months ended October 31, 2015 was primarily a result of a decrease in comparable sales growth driven by weather, a weak macro environment and execution. Our comparable sales decline was driven by lower average dollar sales, resulting from lower average unit retail and units per transaction. Transactions for the DSW segment were flat for the quarter, with lower transaction activity in store but higher online. Traffic in our stores decreased in the low single digits but continued to outperform the retail industry, while we drove traffic online and improved online conversion. Our increase in total net sales for the nine months ended October 31, 2015 was a result of an increase in both comparable sales and new store sales growth.

During the third quarter of fiscal 2015, our comparable sales performance was negative 8% in women's footwear, flat in men's, and negative 5% in accessories. We continued to see momentum in the athletic footwear category which experienced comparable sales of 12%.

Gross Profit. Gross profit is defined as net sales less cost of sales. Gross profit decreased as a percentage of net sales to 29.9% in the third quarter of fiscal 2015 from 32.6% in the third quarter of fiscal 2014. Gross profit decreased as a percentage of net sales to 31.0% in the nine months ended October 31, 2015 from 31.2% in the nine months ended November 1, 2014. By reportable segment and in total, gross profit as a percentage of net sales was:

	Three months ended	Nine months ended
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	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
DSW segment	30.4%	33.5%	31.6%	31.9%
ABG segment	21.9%	18.0%	20.6%	20.2%
Total DSW Inc.	29.9%	32.6%	31.0%	31.2%

Gross profit for the third quarter of fiscal 2015 decreased as a percentage of net sales 270 basis points primarily due to marketing-related markdowns and a lower of cost or market adjustment on a special inventory purchase. Gross profit for the nine months ended October 31, 2015 decreased as a percentage of net sales 20 basis points primarily due to reduced markdown activity, partially offset by lower initial mark up and a lower of cost or market adjustment on a special inventory purchase. Occupancy, distribution and fulfillment center expense rates for the total company deleveraged for the quarter and remained flat year to date compared to last year.

Gross profit for our ABG segment increased for the third quarter of fiscal 2015 primarily due to improved initial mark up and reduced store impairment compared to last year. Gross profit for our ABG segment increased for the nine months ended October 31, 2015 primarily due to reduced store impairment compared to last year.

For the DSW segment, the reconciliation of gross profit to merchandise margin is as follows:

	Three months ended		Nine months ended			
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014		
DSW segment gross profit	30.4	% 33.5	% 31.6	% 31.9	%	
Store occupancy expense	10.7	% 10.2	% 10.8	% 10.8	%	
Distribution and fulfillment expenses	2.2	% 2.0	% 2.1	% 2.1	%	
DSW segment merchandise margin	43.3	% 45.7	% 44.5	% 44.8	%	

Operating Expenses. Operating expenses as a percentage of net sales were 20.4% and 20.7% for the third quarter of fiscal 2015 and fiscal 2014, respectively. The 30 basis point leverage was driven by a reduction in the incentive compensation accrual. Operating expenses as a percentage of net sales were 20.9% and 20.7% for the nine months ended October 31, 2015 and November 1, 2014, respectively. This increase was driven by deleverage in store expenses and overhead costs.

Interest Income, Net. Interest income, net for the third quarter of fiscal 2015 and for the nine months ended October 31, 2015 was essentially flat compared to the third quarter of fiscal 2014 and the nine months ended November 1, 2014.

Non-operating (expense) income. DSW Inc. reported a foreign currency gain of \$3.3 million related to the purchase of \$100 million CAD in the first quarter of 2015. The CAD was invested during the second quarter of 2015 and any foreign exchange gains/losses are recorded in other comprehensive income. Non-operating (expense) income also includes realized capital gains/losses related to the Company's investment portfolio.

Income (Loss) from Town Shoes. Income (loss) from Town Shoes includes DSW's portion of the income or loss in Town Shoes' operations, partially offset by interest income on the shareholder note.

Income from Discontinued Operations. Income from discontinued operations for the nine months ended November 1, 2014 was due to the final distribution from the Filene's Basement debtor's estates.

Income Taxes. The effective tax rate reflects the impact of federal, state and local, and foreign taxes, as well as tax on the income or loss from Town Shoes. The effective tax rate for the three and nine months ended October 31, 2015 was 39.4% and 38.3%, respectively. The effective tax rate for the three and nine months ended November 1, 2014 was 39.3% and 38.5%, respectively.

Non-GAAP Financial Measures

We utilize merchandise margin, defined as gross profit excluding occupancy and distribution and fulfillment expenses, a non-GAAP financial measure, to explain our gross profit performance. Management believes this

non-GAAP measure is an indication of our performance as the measure provides a consistent means of comparing performance between periods and competitors. Management uses this non-GAAP measure to assist in the evaluation of the performance of our segments and to make operating decisions. Within the Management's Discussion and Analysis, we disclose merchandise margin, store occupancy expenses and distribution and fulfillment expenses, as a percentage of net sales.

Seasonality

Our business is subject to seasonal merchandise trends when our customers' interest in new seasonal styles increases. New spring styles are primarily introduced in the first quarter, and new fall styles are primarily introduced in the third quarter. Unlike many other retailers, we have not traditionally experienced a significant increase in net sales during our fourth quarter associated with the winter holiday season.

Liquidity and Capital Resources

Overview. Our primary ongoing cash flow requirements are for inventory purchases and capital expenditures made in connection with our growth strategy, improving our information technology systems 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, pursue our growth strategy and to withstand unanticipated business volatility. We believe that cash generated from our operations, together with our current levels of cash and investments as well as availability under our revolving credit facility, should be sufficient to maintain our ongoing operations, support seasonal working capital requirements, fund capital expenditures related to projected business growth and continue payments of dividends to our shareholders.

Net Working Capital. Net working capital is defined as current assets less current liabilities. As of October 31, 2015, January 31, 2015 and November 1, 2014, net working capital was \$390.0 million, \$484.7 million and \$475.9 million, respectively. As of October 31, 2015, January 31, 2015 and November 1, 2014, the current ratio was 2.4, 2.7 and 2.5, respectively.

Operating Cash Flows. For the nine months ended October 31, 2015, our net cash provided by operations was \$145.3 million compared to \$131.5 million for the nine months ended November 1, 2014 with the change driven primarily by changes in working capital.

Although our plan for continued expansion could place increased demands on our financial, managerial, operational and administrative resources and result in increased demands on management, we do not believe that our anticipated growth plan will have an unfavorable impact on our operations or liquidity. Uncertainty in the United States economy could result in reductions in customer traffic and comparable sales 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 potential 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.

Investing Cash Flows. For the nine months ended October 31, 2015, our net cash used in investing activities was \$6.8 million compared to \$15.0 million for the nine months ended November 1, 2014. During the nine months ended October 31, 2015, we incurred \$82.2 million for capital expenditures, of which \$42.6 million related to new stores and remodels and \$39.6 million related to business infrastructure. During the nine months ended October 31, 2015, we had net sales of short-term and long-term investments of \$70.8 million compared to \$129.2 million during the nine months ended November 1, 2014.

We expect to spend approximately \$115 to \$120 million for capital expenditures in fiscal 2015 for new stores, store remodels and technology and investments, as well as other business projects. Our future investments will depend primarily on the number of stores we open and remodel, infrastructure and information technology programs that we undertake and the timing of these expenditures. We opened 36 new stores in the nine months ended October 31, 2015 and closed two stores. During fiscal 2014, the average investment required to open a typical new DSW store was approximately \$1.5 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 \$0.8 million and new store advertising and other new store expenses typically accounted for \$0.2 million.

Financing Cash Flows. For the nine months ended October 31, 2015, our net cash used in financing activities was \$110.9 million compared to \$132.5 million for the nine months ended November 1, 2014. Net cash used in financing activities was primarily related to the payment of dividends and share repurchases for the nine months ended October

31, 2015 and November 1, 2014.

Our Credit Facility, Letter of Credit Agreement and other liquidity considerations are described more fully below:

\$50 Million Secured Credit Facility. On August 2, 2013, we entered into a secured revolving credit agreement (the "Credit Facility"), which has a term of five years and will expire on July 31, 2018. The Credit Facility may be increased by up to \$100 million upon our request and the increase would be subject to lender availability, our financial condition and compliance with covenants. The Credit Facility is secured by a lien on substantially all of our personal property assets and our subsidiaries with certain exclusions and may be used to provide funds for general corporate purposes, to provide for our ongoing working capital requirements, and to make permitted acquisitions. The Credit Facility contains restrictive covenants relating to our management and the operation of our business. These covenants, among other things, limit or restrict our ability to grant liens on our assets, limit our ability to incur additional indebtedness, limit our ability to enter into transactions with affiliates and limit our ability to merge or consolidate with another entity. The Credit Facility also requires that we meet the minimum cash and investments requirement of \$125 million, as defined in the Credit Facility. An additional covenant limits payments for capital expenditures to \$200 million in any fiscal year. We paid \$79.9 million for capital expenditures for the nine months ended October 31, 2015.

\$50 Million Letter of Credit Agreement- Also on August 2, 2013, we entered into a letter of credit agreement (the "Letter of Credit Agreement"). The Letter of Credit Agreement provides for the issuance of letters of credit up to \$50 million, with a term of five years that will expire on August 2, 2018. The facility for the issuance of letters of credit is secured by a cash collateral account containing cash in an amount equal to 103% of the face amount of any letter of credit extension (105% for extensions denominated in foreign currency) and is used for general corporate purposes.

Contractual Obligations

As of October 31, 2015, January 31, 2015 and November 1, 2014, we had \$4.2 million, \$9.3 million and \$4.5 million, respectively, in outstanding letters of credit and \$4.7 million, \$11.5 million and \$6.0 million, respectively, in restricted cash on deposit under the Letter of Credit Agreement.

As of October 31, 2015, 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 were approximately \$1.2 million as of October 31, 2015. In addition, we have signed lease agreements for 23 new DSW store locations, expected to be opened in fiscal 2015 and 2016 with total annual rent of \$6.2 million. In connection with the new lease agreements, we will receive a total of \$8.5 million of construction and tenant allowance reimbursements for expenditures at these locations.

As of October 31, 2015, we operated all of our stores and our fulfillment center from leased facilities. Lease obligations are accounted for either as operating leases or as capital leases based on a lease by lease review at lease inception. DSW does not have any capital leases of real estate as of October 31, 2015, January 31, 2015 and November 1, 2014.

Future Cash

The Company is not dependent on dividends from its foreign subsidiaries to fund its U.S. operations or make distributions to DSW stockholders. Unremitted earnings from foreign subsidiaries, which are considered to be invested indefinitely, would become subject to income tax if they were remitted as dividends or were lent to DSW Inc. or a U.S. affiliate.

Foreign Currency

During the first quarter of 2015, we held \$100 million CAD in Canadian bank accounts. During the second quarter of 2015, we invested the CAD in available-for-sale investments in Canada in anticipation of funding the future purchase of the remaining interest in Town Shoes of Canada or pursue other business opportunities if they became available, but we would be able to return the funds to U.S. operations if we do not purchase the remaining interest or if U.S. operations require the cash.

Off-Balance Sheet Arrangements

As of October 31, 2015, DSW Inc. has not entered into any "off-balance sheet" arrangements, as that term is described by the Securities and Exchange Commission.

Proposed Accounting Standards

The Financial Accounting Standards Board periodically issues Accounting Standard Updates, some of which require implementation by a date falling within or after the close of the fiscal year. See Note 3 to the condensed consolidated financial statements for new accounting standards that will impact DSW.

Critical Accounting Policies and Estimates

As discussed in Notes 1 and 3 to our condensed consolidated interim financial statements included elsewhere in this Quarterly Report on Form 10-Q, the preparation of our condensed consolidated interim financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the condensed consolidated interim financial statements and reported amounts of revenues and expenses during the reporting period. 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Cash and Equivalents and Investments- Our cash and equivalents have maturities of 90 days or less. At times, cash and equivalents may be in excess of Federal Deposit Insurance Corporation (“FDIC”) insurance limits. We also have available-for-sale investments. These financial instruments may be subject to interest rate risk through lost income should interest rates increase during their term to maturity and thus may limit our ability to invest in higher income investments.

\$50 Million Credit Facility and \$50 Million Letter of Credit Agreement- As of October 31, 2015, there was no long-term debt outstanding. Future borrowings, if any, would bear interest at rates in accordance with our credit facility and credit agreement 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.

Foreign Currency Exchange Risk- As a result of our equity investment in Town Shoes, we are exposed to foreign currency rate risk. We currently do not utilize hedging instruments to mitigate foreign currency exchange risks.

During the first quarter of 2015, we held \$100 million CAD in Canadian bank accounts. During the second quarter of 2015, we invested the \$100 million CAD in available-for-sale securities in Canada. As the CAD was fully invested during the second quarter of 2015, any gains/losses due to remeasurement will be recorded in other comprehensive income. If the funds are transferred to cash, we will be exposed to foreign currency rate risk due to remeasurement in our statement of operations.

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 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, as such term is defined in Exchange Act Rules 13a-15(f) or 15d-15(e), during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Other legal proceedings- The Company is 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. When a liability is probable and there is a range of estimated loss, we record the most likely estimated liability related to the claim. Although it is not possible to predict with certainty the eventual outcome of any litigation, in the opinion of management, the amount of any potential liability with respect to these proceedings will not be material to our results of operations or financial condition.

Item 1A. Risk Factors.

The following risk factor supplements the Company's risk factors as set forth in Part I, Item 1A of our last Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

Foreign Currency Exchange Risk- As a result of our equity investment in Town Shoes, we are exposed to foreign currency rate risk. We currently do not utilize hedging instruments to mitigate foreign currency exchange risks. During the first quarter of 2015, we held \$100 million CAD in Canadian bank accounts. During the second quarter of 2015, we invested the \$100 million CAD in available-for-sale securities in Canada. As the CAD was fully invested during the second quarter of 2015, any gains/losses due to remeasurement will be recorded in other comprehensive income. If the funds are transferred to cash, we will be exposed to foreign currency rate risk due to remeasurement in our statement of operations.

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

(a) Recent sales of unregistered securities. None.

(b) Use of Proceeds. Not applicable.

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

\$150 Million Share Repurchase Program- During the three and nine months ended October 31, 2015, DSW Inc. repurchased 2.1 million Class A Common Shares at a cost of \$63.1 million, completing its prior \$150 million share repurchase authorization. On November 2, 2015, the Board of Directors approved an additional \$200 million share repurchase authorization. The share repurchase program may be suspended, modified or discontinued at any time, and the Company has no obligation to repurchase any amount of its common shares under the program. Shares will be repurchased on the open market at times and in amounts considered appropriate by the Company based on price and market conditions. The shares withheld and repurchased are summarized in the table below:

Period	Total number of shares purchased (a)	Average price paid per share (b)	Total number of shares purchased as part of publicly announced programs	Approximate dollar value of shares that may yet be purchased under the programs (in thousands)
August 2, 2015 to August 29, 2015	—	—	—	\$63,062
August 30, 2015 to October 3, 2015	—	\$29.47	2,140	—
October 4, 2015 to October 31, 2015	—	—	—	—
	—	\$29.47	2,140	—

(a) The total number of shares repurchased includes shares repurchased as part of publicly announced programs, with the remainder relating to shares withheld in connection with tax payments due upon vesting of employee restricted stock awards.

(b) The average price paid per share includes any broker commissions.

Dividends- The payment of any future dividends is at the discretion of our Board of Directors and is based on our future earnings, cash flow, financial condition, capital requirements, changes in taxation laws, general economic condition and any other relevant factors. It is anticipated that dividends will be declared on a quarterly basis.

Item 3. Defaults Upon Senior Securities. None.

Item 4. Mine Safety Disclosures. Not Applicable.

Item 5. Other Information. None.

Item 6. Exhibits. See Index to Exhibits on page 27.

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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: December 2, 2015

By: /s/ Mary Meixelsperger

Mary Meixelsperger

Senior Vice President and Chief Financial Officer

(principal financial and accounting officer and duly authorized officer)

INDEX TO EXHIBITS

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of DSW Inc. dated November 1, 2013. Incorporated by reference to Exhibit 3.1 to DSW's Form 8-K (file no. 001-32545) filed November 4, 2013.
3.2	Amended and Restated Code of Regulations of DSW Inc. Incorporated by reference to Exhibit 3.2 to DSW's Form 10-K (file no. 001-32545) filed April 13, 2006.
4.1	Specimen Class A Common Shares Certificate. Incorporated by reference to Exhibit 4.1 to DSW's Form 10-K (file no. 001-32545) filed April 13, 2006.
10.1	Retirement and Consulting Agreement. Incorporated by reference to Form 8-K (file no. 001-32545) filed November 25, 2015.
31.1	* Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	* Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1	* Section 1350 Certification of Chief Executive Officer
32.2	* Section 1350 Certification of Chief Financial Officer
101	* XBRL Instance Documents
* Filed herewith	