DSW Inc.
Form 10-Q
September 01, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2010

OR

o 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 (State or other jurisdiction of Incorporation or organization)	31-0746639 (I.R.S. Employer Identification No.)
810 DSW Drive, Columbus, Ohio (Address of principal executive offices)	43219 (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. x Yes o 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). o Yes o 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 o	Accelerated filer x	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

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

The number of outstanding Class A Common Shares, without par value, as of August 27, 2010 was 16,638,541 and Class B Common Shares, without par value, as of August 27, 2010 was 27,382,667.

DSW INC.

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	July 31, 2010	January 30, 2010
ASSETS		
Cash and equivalents	$72,986	$125,020
Short-term investments	198,964	164,265
Accounts receivable, net	10,262	5,406
Accounts receivable from related parties, net	35	123
Inventories	309,143	262,284
Prepaid expenses and other current assets	21,658	20,762
Deferred income taxes	32,774	29,130
Total current assets	645,822	606,990
Long-term investments, net	19,319	1,151
Property and equipment, net	201,578	206,424
Goodwill	25,899	25,899
Deferred income taxes and other assets	11,813	10,292
Total assets	$904,431	$850,756
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable	$139,554	$119,064
Accounts payable to related parties	889	1,495
Accrued expenses:		
Compensation	14,563	26,244
Taxes	21,290	28,882
Gift cards and merchandise credits	16,493	17,774
Other	31,411	31,260
Total current liabilities	224,200	224,719
Non-current liabilities	96,308	101,156
Commitments and contingencies		
Shareholders' equity:		
Class A Common Shares, no par value; 170,000,000 authorized; 16,637,641 and 16,508,581 issued and outstanding, respectively	311,527	306,123
Class B Common Shares, no par value; 100,000,000 authorized; 27,382,667 and 27,382,667 issued and outstanding, respectively		
Preferred Shares, no par value; 100,000,000 authorized; no shares issued or outstanding		
Retained earnings	272,396	218,758
Total shareholders' equity	583,923	524,881
Total liabilities and shareholders' equity	$904,431	$850,756

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

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

	Three months ended		Six months ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
Net sales	$415,120	$369,490	$864,657	$755,336
Cost of sales	(289,402)	(271,702)	(591,574)	(552,567)
Operating expenses	(87,623)	(86,427)	(185,843)	(179,305)
Operating profit	38,095	11,361	87,240	23,464
Interest expense	(236)	(188)	(488)	(371)
Interest income	373	766	1,410	1,203
Interest income, net	137	578	922	832
Non-operating income, net		528		133
Earnings before income taxes	38,232	12,467	88,162	24,429
Income tax provision	(14,778)	(4,900)	(34,524)	(9,717)
Net income	$23,454	$7,567	$53,638	$14,712
Basic and diluted earnings per share:				
Basic	$0.53	$0.17	$1.22	$0.33
Diluted	$0.52	$0.17	$1.20	$0.33
Shares used in per share calculations:				
Basic	43,988	44,074	43,948	44,046
Diluted	44,826	44,420	44,800	44,355

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						
	Class A Common Shares	Class B Common Shares	Class A Common Shares	Class B Common Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, January 31, 2009	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)
Total comprehensive income							14,638
Stock units granted	45		570				570
Vesting of restricted stock units, net of settlement of taxes	54		(177)				(177)
Stock based compensation expense, before related tax effects			2,917				2,917
Balance, August 1, 2009	16,415	27,703	$297,532	$0	$186,729	$ (729)	$483,532
Balance, January 30, 2010	16,509	27,383	$306,123	$0	$218,758	$ 0	$524,881
Net income					53,638		53,638
Stock units granted	31		829				829
Exercise of stock options	71		997				997
Vesting of restricted stock units, net of settlement of taxes	27		(281)				(281)
Excess tax benefit related to stock option exercises			283				283
Non-cash capital contribution from Retail Ventures			767				767
Stock based compensation expense, before related tax effects			2,809				2,809
Balance, July 31, 2010	16,638	27,383	$311,527	$0	$272,396	$ 0	$583,923

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

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

	Six months ended July 31, 2010	Six months ended August 1, 2009
Cash flows from operating activities:		
Net income	$53,638	$14,712
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,167	22,724
Amortization of debt issuance costs	62	59
Stock based compensation expense	2,809	2,917
Deferred income taxes	(7,642)	(3,437)
Loss on disposal of long-lived assets	219	156
Impairment charges on long-lived assets		1,645
Non-operating income, net		(133)
Grants of stock units	829	570
Other	(1,310)	(2,031)
Change in working capital, assets and liabilities:		
Accounts receivable, net	(5,292)	(1,770)
Inventories	(46,859)	(20,287)
Prepaid expenses and other current assets	(896)	3,386
Accounts payable	18,507	8,600
Proceeds from construction and tenant allowances	1,024	4,867
Accrued expenses	(19,831)	4,450
Net cash provided by operating activities	$18,425	$36,428
Cash flows from investing activities:		
Cash paid for property and equipment	(17,313)	(14,973)
Purchases of available-for-sale investments	(22,568)	(109,313)
Purchases of held-to-maturity investments	(107,625)	(5,175)
Maturities and sales of available-for-sale investments	57,427	77,530
Maturities of held-to-maturity investments	19,021	
Return of capital from equity investment – related party	199	
Purchase of tradename	(200)	
Net cash used in investing activities	$(71,059)	$(51,931)
Cash flows from financing activities:		
Proceeds from exercise of stock options	997	
Debt issuance costs	(680)	
Excess tax benefit – related to stock option exercises	283	
Net cash provided by financing activities	$600	
Net decrease in cash and equivalents	(52,034)	(15,503)
Cash and equivalents, beginning of period	125,020	54,782
Cash and equivalents, end of period	$72,986	$39,279

Supplemental disclosures of cash flow information:		
Cash paid during the period for income taxes	$50,932	$7,318
Noncash investing and operating activities –		
Balance of accounts payable and accrued expenses due to property and equipment purchases	2,753	1,442
Decrease in accounts payable related to recovery from RVI of shared service asset impairment		(1,818)
Non-cash capital contribution from Retail Ventures	767	

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

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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 March 24, 2010 (the "2009 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 under the ticker symbol "DSW". As of July 31, 2010, Retail Ventures, Inc. ("RVI" or "Retail Ventures") owned approximately 62.2% of DSW's outstanding Common Shares, representing approximately 92.9% of the combined voting power of DSW's outstanding Common Shares.

DSW has two reportable segments: the DSW segment, which includes DSW stores and dsw.com, and leased departments. DSW stores and dsw.com offer a wide assortment of better-branded dress, casual and athletic footwear for men and women, as well as handbags and accessories. As of July 31, 2010, DSW operated a total of 310 stores located throughout the United States. During the six months ended July 31, 2010, DSW opened five new DSW stores, closed one DSW store and recategorized one combination DSW/Filene's Basement store as a DSW store.

DSW also operates leased departments for four retailers in its leased department segment. As of July 31, 2010, DSW supplied merchandise to 264 Stein Mart stores, 68 Gordmans stores, 21 Filene's Basement stores and one Frugal Fannie's store. During the six months ended July 31, 2010, DSW added three new leased departments and ceased operations in four leased departments. DSW owns the merchandise and the fixtures (except for Filene's Basement, where DSW only owns the merchandise), records sales of merchandise, net of returns and sales tax and provides management oversight. The retailers provide the sales associates and retail space. DSW pays a percentage of net sales as rent.

Allowance for Doubtful Accounts- The Company monitors its exposure for credit 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 July 31, 2010 and January 30, 2010, the Company's allowances for doubtful accounts were $1.1 million and $1.3 million, respectively.

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 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.

DSW records a reduction to inventories and charge to cost of sales for shrinkage. Shrinkage is calculated as a percentage of sales from the last physical inventory date. Estimates are based on both historical experience as well as recent physical inventory results. Physical inventory counts are taken on an annual basis and have supported the Company's shrinkage estimates.

Markdowns represent the excess of the carrying value over the amount the Company expects to realize from the ultimate disposition of the inventory. Factors considered in the determination of markdowns include customer preference and fashion trends. Changes in facts or circumstances do not result in the reversal of previously recorded markdowns or an increase in that newly established cost basis.

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

Tradenames and Other Intangible Assets, Net- Tradenames and other intangible assets, net are primarily comprised of values assigned to tradenames and leases at the time of RVI's acquisition of the Company. As of July 31, 2010 and January 30, 2010, the gross balance of tradenames was $13.0 million and $12.8 million, respectively. During the three months ended July 31, 2010, DSW purchased a merchandise trade name for the amount of $0.2 million, amortizable over five years. As of both July 31, 2010 and January 30, 2010, the gross balance of other intangible assets was $0.1 million. Accumulated amortization for tradenames was $10.4 million and $10.0 million as of July 31, 2010 and January 30, 2010, respectively. Accumulated amortization for other intangible assets was $0.1 million as of both July 31, 2010 and January 30, 2010. The average useful lives of tradenames and other intangible assets, net are 14 and 15 years as of July 31, 2010 and January 30, 2010, respectively.

Amortization expense for the six months ended July 31, 2010 was $0.4 million, and $0.5 million will be amortized during the remainder of fiscal 2010. Amortization expense associated with the net carrying amount of intangible assets as of July 31, 2010 is $0.9 million for both fiscal 2011 and fiscal 2012, $0.3 million in fiscal 2013 and less than $0.1 million in fiscal 2014.

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 expire six months after being issued. 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 July 31, 2010 and January 30, 2010 was $10.7 million and $9.0 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 amounts 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 non-current liabilities was $32.0 million and $32.3 million as of July 31, 2010 and January 30, 2010, respectively.

Construction and Tenant Allowances- The Company receives cash allowances from landlords, which are deferred and amortized on a straight-line basis over the original terms of the lease as a reduction of rent expense. Construction and tenant allowances are included in non-current liabilities and were $58.1 million and $59.7 million as of July 31, 2010 and January 30, 2010, respectively.

Sales and Revenue Recognition- Revenues from merchandise sales are recognized upon customer receipt of merchandise, are net of returns through period end 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 and also includes revenue from shipping and handling in net sales 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 other operating income from gift card breakage during both of the three months ended July 31, 2010 and August 1, 2009. The Company recognized $0.4 million as other operating income from gift card breakage during both of the six months ended July 31, 2010 and August 1, 2009.

Cost of Sales- In addition to the cost of merchandise, which includes markdowns and shrinkage, the Company includes in the cost of sales expenses associated with warehousing (including depreciation), distribution and store occupancy (excluding depreciation and 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, new store advertising and other new store 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.

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

Non-operating Income, Net- Non-operating income, net includes other-than-temporary impairments related to investments and realized gains on disposition of investments.

Income Taxes- Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis 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.

Comprehensive Income- For the six months ended July 31, 2010, comprehensive income was equal to net income. For the six months ended August 1, 2009, comprehensive income was $14.6 million, $0.1 million less than net income of $14.7 million due to unrealized losses on available for sale securities.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board ("FASB") issued updates to existing guidance related to fair value measurements. As a result of these updates, entities will be required to provide enhanced disclosures about transfers into and out of level 1 and level 2 classifications, provide separate disclosures about purchases, sales, issuances and settlements relating to the tabular reconciliation of beginning and ending balances of the level 3 classification and provide greater disaggregation for each class of assets and liabilities that use fair value measurements. Except for the detailed level 3 disclosures, the new standard was effective for the Company for the first quarter of fiscal 2010. The requirement related to level 3 fair value measurements is effective for the Company for interim and annual reporting periods beginning after January 29, 2011. The adoption of the effective portions of this new standard did not have a material impact to the Company's consolidated financial statements and the Company does not expect a material impact to its consolidated financial statements related to the level 3 fair value disclosures.

2. RELATED PARTY TRANSACTIONS

RVI- Accounts payable to RVI of $0.5 million and $1.0 million as of July 31, 2010 and January 30, 2010, respectively, were primarily related to DSW's usage of RVI's net operating losses prior to fiscal 2007 under the Tax Separation Agreement, shared services and other intercompany transactions. During the six months ended July 31, 2010, accounts payable were reduced by $0.5 million due to RVI's reimbursement of certain DSW leasehold improvement expenditures.

During the six months ended July 31, 2010, RVI contributed tax benefits to DSW resulting in non-cash capital contributions of $0.8 million.

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 by or affiliated with SSC or intercompany transactions with SSC and normally settle in the form of cash in 30 to 60 days. These related party balances as of July 31, 2010 and January 30, 2010, were related party receivables of less than $0.1 million and $0.1 million, respectively, and related party payables of $0.4 million and $0.5 million, respectively.

3. STOCK BASED COMPENSATION

The Company 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. The Plan covers stock options, restricted stock units and director stock units. Eligible recipients include key employees of the Company and affiliates, as well as directors of the Company. Options generally vest 20% per year on a cumulative basis. Options granted under the Plan generally remain exercisable for a period of ten years from the date of grant. Prior to fiscal 2005, the Company did not have a stock option plan or any equity units outstanding.

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

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

	Six months ended July 31, 2010
Outstanding, beginning of period	2,504
Granted	522
Exercised	(71)
Forfeited	(44)
Outstanding, end of period	2,911
Exercisable, end of period	1,169

DSW expensed $2.4 million and $2.2 million, respectively, for the six months ended July 31, 2010 and August 1, 2009 related to stock options. The weighted-average grant date fair value of each option granted in the six months ended July 31, 2010 and August 1, 2009 was $13.40 and $5.07 per share, respectively. The total aggregate intrinsic value of nonvested DSW stock options as of July 31, 2010 was $16.2 million. As of July 31, 2010, the total compensation cost related to nonvested DSW stock options not yet recognized was approximately $10.4 million with a weighted average expense recognition period remaining of 3.0 years. 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	
	July 31, 2010	August 1, 2009
Assumptions:		
Risk-free interest rate	2.5%	1.9%
Expected volatility of DSW common stock	56.9%	57.6%
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 ended July 31, 2010
Outstanding, beginning of period	267
Granted	59
Vested	(37)
Forfeited	(2)
Outstanding, end of period	287

DSW expensed $0.4 million and $0.7 million, respectively, for the six months ended July 31, 2010 and August 1, 2009 related to restricted stock units. The total aggregate intrinsic value of nonvested restricted stock units as of July 31, 2010 was $7.6 million. As of July 31, 2010, 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 1.6 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 July 31, 2010 and August 1, 2009, DSW granted 30,698 and 45,130 director stock units, respectively, and expensed $0.8 million and $0.6 million in each respective six month period for these grants. As of July 31, 2010, 160,403 director stock units had been issued and no director stock units had been settled.

4. INVESTMENTS

The Company determines the 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. Otherwise, investments are classified as available-for-sale. Excluding certificates of deposit, the majority of the Company's short-term available-for-sale investments generally have renewal dates of every 7 days, and certificates of deposit mature every 61 days. In addition to short-term investments, the Company has invested in certain longer term bonds to receive higher returns. These long-term investments have maturities greater than one year but generally shorter than two years, are classified as held-to-maturity and are included within other assets on the condensed consolidated balance sheet. The Company also received a return of capital of $0.2 million related to its related party equity investment.

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

The following table discloses the major categories of the Company's investments as of the periods presented:

	Short-term investments		Long-term investments, net	
	July 31, 2010	January 30, 2010	July 31, 2010	January 30, 2010
Available-for-sale:		(in thousands)		
Bonds	$ 105,190	$ 124,107		
Commercial paper	6,000	8,100		
Certificates of deposit	1,000	15,000		
Total available-for-sale investments	$ 112,190	$ 147,207		
Held-to-maturity:				
Term notes	86,774	17,058		
Bonds			$ 18,367	
Equity investment – related party			952	$ 1,151
Total investments	$ 198,964	$ 164,265	$ 19,319	$ 1,151

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.
- 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 the periods presented consisted of the following:

	As of July 31, 2010				As of January 30, 2010			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
				(in thousands)				
Cash and equivalents	$ 72,986	$ 72,986			$ 125,020	$ 125,020		
Short-term investments, net	198,964		$ 198,964		164,265		$ 164,265	
	19,319		18,367	$ 952	1,151			$ 1,151

Long-term investments, net	$ 291,269	$ 72,986	$ 217,331	$ 952	$ 290,436	$ 125,020	$ 164,265	$ 1,151

Cash and equivalents primarily represent cash deposits and investments in money market funds held with financial institutions, as well as credit card receivables that generally settle within three days. Equity investments are evaluated for other-than-temporary impairment using level 3 inputs such as the financial condition and future prospects of the entity. The Company's available-for-sale and held-to maturity investments are valued using a market-based approach using level 2 inputs such as prices of similar assets in active markets.

The following table presents the activity related to level 3 fair value measurements for the periods presented:

	For the three months ended			
	July 31, 2010		August 1, 2009	
	Short-term investments	Long-term investments, net	Short-term investments	Long-term investments, net
	(in thousands)			
Carrying value at the beginning of the period	$ 0	$ 952	$ 1,596	$ 0
Unrealized gains included in accumulated other comprehensive loss			175	
Carrying value at the end of the period	$ 0	$ 952	$ 1,771	$ 0

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

	For the six months ended			
	July 31, 2010		August 1, 2009	
	Short-term investments	Long-term investments, net	Short-term investments	Long-term investments, net
	(in thousands)			
Carrying value at the beginning of the period	$ 0	$ 1,151	$ 1,845	$ 1,266
Transfer out of level 3				(1,266)
Return of capital from equity investment		(199)		
Unrealized losses included in accumulated other comprehensive loss			(74)	
Carrying value at the end of the period	$ 0	$ 952	$ 1,771	$ 0

There were no non-financial assets measured on a nonrecurring basis during the six months ended July 31, 2010. As of August 1, 2009, 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.

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 or asset group is considered impaired when the carrying value of the asset or asset group exceeds the expected future cash flows from the asset or asset group. 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 or asset group 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.

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	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
	(in thousands)			
Weighted average shares outstanding	43,988	44,074	43,948	44,046
Assumed exercise of dilutive stock options	552		569	
Assumed exercise of dilutive restricted stock units	286	346	283	309
	44,826	44,420	44,800	44,355

Number of shares for computation of
diluted earnings per share

Options to purchase 1.0 million and 2.7 million common shares were outstanding for the three months ended July 31, 2010 and August 1, 2009, respectively, and options to purchase 1.0 million and 2.8 million common shares were outstanding for the six months ended July 31, 2010 and August 1, 2009, 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 $100 MILLION CREDIT FACILITY

On June 30, 2010, the Company entered into a $100 million secured revolving credit facility (the "Credit Facility") with a term of four years that will expire on June 30, 2014. Under this facility, the Company and its subsidiary, DSW Shoe Warehouse, Inc. ("DSWSW"), are named as co-borrowers, with all other subsidiaries listed as guarantors. The Credit Facility may be increased by up to $75 million upon the Company's request and approval by increasing lenders and subject to customary conditions. The Credit Facility provides for swing loans of up to $10 million and the issuance of letters of credit up to $50 million. The Credit Facility is secured by a lien on substantially all of the personal property assets of the Company and its subsidiaries with certain exclusions and will be used to provide funds for general corporate purposes, to refinance existing letters of credit outstanding under the Company's previous credit arrangement and to provide for the ongoing working capital requirements of the Company. Revolving credit loans bear interest under the Credit Facility at the Company's option under: (A) a base rate option at a rate per annum equal to the highest of (i) the Federal Funds Open Rate (as defined in the Credit Agreement), plus 0.5%, (ii) the Agent's prime rate, and (iii) the Daily LIBOR Rate (as defined in the Credit Agreement) plus 1.0%, plus in each instance an applicable margin based upon the Company's revolving credit availability; or (B) a LIBOR option at rates equal to the one, two, three, or six month LIBOR rates, plus an applicable margin based upon the Company's revolving credit availability. Swing loans bear interest under the base rate option. The Company's right to obtain advances under the credit facility is limited by a borrowing base. In addition, the Credit Facility contains usual and customary 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, incur additional indebtedness, enter into transactions with affiliates, merge or consolidate with another entity, redeem our stock and pay cash dividends up to the aggregate amount of 50% of the previous year's net income, for a maximum of $50.0 million.

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

As of July 31, 2010, the Company had no outstanding borrowings, had availability under the facility of $72.2 million and had outstanding letters of credit of $27.8 million. As of January 30, 2010 under its previous credit facility, the Company had no outstanding borrowings, had availability under the facility of $132.6 million and had outstanding letters of credit of $17.4 million.

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 38.7% and 39.3%, respectively, for the three months ended July 31, 2010 and August 1, 2009. The Company's effective tax rate was 39.2% and 39.8%, respectively, for the six months ended July 31, 2010 and August 1, 2009.

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.

9. SEGMENT REPORTING

DSW has two reportable segments: the DSW segment, which includes DSW stores and 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 July 31, 2010 and January 30, 2010 is recorded in the DSW segment related to the DSW stores operating segment. The following tables present segment information for the Company's two reportable segments:

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

	DSW	Leased departments (in thousands)	Total
Three months ended July 31, 2010:			
Net sales	$ 381,918	$ 33,202	$ 415,120
Gross profit	118,917	6,801	125,718
Capital expenditures	8,906	0	8,906
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
Six months ended July 31, 2010:			
Net sales	$ 793,544	$ 71,113	$ 864,657
Gross profit	257,242	15,841	273,083
Capital expenditures	18,038	57	18,095
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
As of July 31, 2010:			
Total assets	$ 828,690	$ 75,741	$ 904,431
As of January 30, 2010:			
Total assets	$ 784,213	$ 66,543	$ 850,756

10. LEGAL PROCEEDINGS

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. When 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 the amount of potential liability could materially impact the Company's future results of operations and financial condition.

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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 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.

Company Overview

DSW is a leading U.S. branded footwear specialty retailer operating 310 shoe stores in 39 states as of July 31, 2010. We offer a wide assortment of better-branded dress, casual and athletic footwear for women and men, as well as accessories through our DSW stores and dsw.com. In addition, we operate 353 leased departments for four other retailers as of July 31, 2010. Our typical DSW customers are brand, value, quality and style-conscious shoppers who have a passion for footwear and accessories. Our core focus is to create a distinctive shopping experience that satisfies both the rational and emotional shopping needs of our DSW customers by offering them a vast, exciting assortment of in-season styles combined with the convenience and value they desire. Our DSW stores average approximately 22,000 square feet and can carry approximately 26,000 pairs of shoes. 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.

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 the negat 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 our Form 10-K filed on March 24, 2010, 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 sales and quarterly financial performance;
- disruption of our distribution operations;
- failure to retain our key executives or attract qualified new personnel;

- our competitiveness with respect to style, price, brand availability and customer service;
- uncertain general economic conditions;
- risks inherent to international trade with countries that are major manufacturers of footwear;
- risks related to our cash and investments;
- the success of dsw.com;
- RVI's lease of an office 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.

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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 30, 2010 contained in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission ("SEC") on March 24, 2010 (the "2009 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 2009 Annual Report.

Results of Operations

Overview

During the six months ended July 31, 2010, we generated a 14.1% increase in comparable sales and a 14.5% increase in total sales. The significant increase in comparable sales was primarily driven by an increase in transactions, as more customers visited our stores and a higher percentage of those customers made purchases. All merchandise categories reported a strong performance, with no single category driving the overall sales increase.

The sales increase exceeded our expectations entering the season, which resulted in a reduction of markdown activity and improved merchandise margins. Occupancy expenses decreased due to a reduction in impairments of long-lived assets. Operating expenses, excluding bonus, were relatively flat to last year due to expense management and leveraged significantly as a percentage of sales. As a result of sales growth, improved merchandise margins and expense management, operating profit for the six months ended July 31, 2010 as a percentage of net sales improved 700 basis points over the prior year to 10.1%.

We have continued making investments in our business that are critical to long-term growth. During the six months ended July 31, 2010, we invested $18.1 million in capital expenditures primarily related to opening new stores, remodeling existing stores and improving our information technology systems. As of July 31, 2010, our cash and short-term investments balance was $272.0 million. We also have $19.3 million in long-term investments and no long-term debt.

As of July 31, 2010, we operated 310 DSW stores, dsw.com and leased departments in 264 Stein Mart stores, 68 Gordmans stores, 21 Filene's Basement stores and one Frugal Fannie's store. DSW has two reportable segments: the DSW segment, which includes DSW stores and dsw.com, and leased departments.

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			
	July 31, 2010		August 1, 2009		July 31, 2010		August 1, 2009	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	(69.7	)	(73.5	)	(68.4	)	(73.2	)
Gross profit	30.3		26.5		31.6		26.8	
Operating expenses	(21.1	)	(23.4	)	(21.5	)	(23.7	)

Operating profit	9.2	3.1	10.1	3.1
Interest income, net	0.0	0.2	0.1	0.1
Non-operating income, net		0.1		0.0
Earnings before income taxes	9.2	3.4	10.2	3.2
Income tax provision	(3.5)	(1.3)	(4.0)	(1.3)
Net income	5.7 %	2.1 %	6.2 %	1.9 %

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THREE MONTHS ENDED JULY 31, 2010 COMPARED TO THREE MONTHS ENDED AUGUST 1, 2009

Net Sales. Net sales for the second quarter of fiscal 2010 increased 12.3% from the second quarter of fiscal 2009. The following table summarizes the increase in our net sales:

	Three months ended July 31, 2010 (in millions)
Net sales for the three months ended August 1, 2009	$ 369.5
Increase in comparable sales	43.2
Net increase from 2009 and 2010 new stores and closed store sales	2.4
Net sales for the three months ended July 31, 2010	$ 415.1

The following table summarizes our net sales by reportable segment:

	Three months ended	
	July 31, 2010	August 1, 2009
	(in millions)	
DSW	$381.9	$335.2
Leased departments	33.2	34.3
Total DSW Inc.	$415.1	$369.5

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

	Three months ended July 31, 2010
DSW	12.5%
Leased departments	5.7%
Total DSW Inc.	12.0%

Beginning in the first quarter of fiscal 2010, dsw.com is included in the change in comparable sales. The inclusion of dsw.com did not significantly impact our comparable sales change percentage for the second quarter of fiscal 2010. The increase in comparable sales was primarily a result of an increase in transactions driven by more customers visiting our stores and a higher percentage of those customers making purchases. For the DSW segment, all merchandise categories had positive comparable sales. DSW segment comparable sales increased in women's footwear by 13.6%, men's by 14.9%, athletic by 10.0% and accessories by 5.9%.

Gross Profit. Gross profit is defined as net sales less cost of sales. Gross profit increased as a percentage of net sales from 26.5% in the second quarter of fiscal 2009 to 30.3% in the second quarter of fiscal 2010. By reportable segment and in total, gross profit as a percentage of net sales was:

	Three months ended	
	July 31, 2010	August 1, 2009

DSW	31.1%	27.5%
Leased departments	20.5%	16.7%
Total DSW Inc.	30.3%	26.5%

DSW segment merchandise margin, gross profit excluding occupancy and warehousing expenses, increased as a percentage of net sales to 45.4% for the second quarter of fiscal 2010 from 43.4% for the comparable period last year as a result of sales exceeding our expectations which led to a reduction in markdown activity. Store occupancy expense for the DSW segment as a percentage of net sales decreased to 12.7% for the second quarter of fiscal 2010 from 14.4% for the comparable period last year as a result of increased average store sales and a reduction in impairments of long-lived assets. Warehousing expense as percentage of net sales was relatively flat to last year.

Gross profit for the leased departments increased as a percentage of net sales for the second quarter of fiscal 2010 due to a reduction in markdown activity. This reduction was due to aligning inventory position to sales demand and fewer markdowns related to store closures.

Operating Expenses. Operating expenses as a percentage of net sales were 21.1% and 23.4% for the three months ended July 31, 2010 and August 1, 2009, respectively. Operating expenses leveraged as a result of both the sales increase compared to last year and expense management. Overhead, store, and marketing expenses decreased significantly as a percentage of net sales, and were partially offset by an increase in bonus expense due to improved operating results.

Interest Income, Net. Interest income, net of interest expense, was 0.0% and 0.2%, respectively, as a percentage of net sales for the second quarters of fiscal 2010 and 2009.

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Non-operating income, Net. There was no non-operating income for the second quarter of fiscal 2010. Non-operating income for the second quarter of fiscal 2009 represents the realized gain related to the sales of investments in preferred shares.

Income Taxes. Our effective tax rate for the second quarter of fiscal 2010 was 38.7%, compared to 39.3% for the second quarter of fiscal 2009.

Net Income. For the second quarter of fiscal 2010, net income increased 210%, compared to the second quarter of fiscal 2009 and represented 5.7% and 2.1% of net sales for the second quarters of fiscal 2010 and 2009, respectively. As a percentage of net sales, this increase was primarily the result of the increase in gross profit and the decrease in operating expenses.

SIX MONTHS ENDED JULY 31, 2010 COMPARED TO SIX MONTHS ENDED AUGUST 1, 2009

Net Sales. Net sales for the six months ended July 31, 2010 increased 14.5% from the six months ended August 1, 2009. The following table summarizes the increase in our net sales:

	Six months ended July 31, 2010 (in millions)
Net sales for the six months ended August 1, 2009	$ 755.3
Increase in comparable sales	104.6
Net increase from 2009 and 2010 new stores and closed store sales	4.8
Net sales for the six months ended July 31, 2010	$ 864.7

The following table summarizes our net sales by reportable segment:

	Six months ended July 31, 2010	Six months ended August 1, 2009
	(in millions)	
DSW	$793.6	$679.3
Leased departments	71.1	76.0
Total DSW Inc.	$864.7	$755.3

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

	Six months ended July 31, 2010
DSW	15.2%
Leased departments	3.8%
Total DSW Inc.	14.1%

Beginning in the first quarter of fiscal 2010, dsw.com is included in the change in comparable sales. The inclusion of dsw.com did not significantly impact our comparable sales change percentage for the six months ended July 31, 2010. The increase in comparable sales was primarily a result of an increase in transactions driven by more customers visiting our stores and a higher percentage of those customers making purchases. For the DSW segment, all merchandise categories had positive comparable sales. DSW segment comparable sales increased in women's footwear by 15.8%, men's by 15.7%, athletic by 13.5% and accessories by 9.8%.

Gross Profit. Gross profit is defined as net sales less cost of sales. Gross profit increased as a percentage of net sales from 26.8% in the six months ended August 1, 2009 to 31.6% in the six months ended July 31, 2010. By reportable segment and in total, gross profit as a percentage of net sales was:

	Six months ended	
	July 31, 2010	August 1, 2009
DSW	32.4%	27.8%
Leased departments	22.3%	18.2%
Total DSW Inc.	31.6%	26.8%

DSW segment merchandise margin, gross profit excluding occupancy and warehousing expenses, increased as a percentage of net sales to 45.9% for the six months ended July 31, 2010 from 43.6% for the comparable period last year as a result of sales exceeding our expectations which led to a reduction in markdown activity. Store occupancy expense for the DSW segment as a percentage of net sales decreased to 11.9% for the six months ended July 31, 2010 from 14.2% for the comparable period last year as a result of increased average store sales and a reduction in non-rent related expenses. Warehousing expense as percentage of net sales was relatively flat to last year.

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Gross profit for the leased departments increased as a percentage of net sales for the six months ended July 31, 2010 due to a reduction in markdown activity. This reduction was due to aligning inventory position to sales demand and fewer markdowns related to store closures.

Operating Expenses. Operating expenses as a percentage of net sales were 21.5% and 23.7% for the six months ended July 31, 2010 and August 1, 2009, respectively. Operating expenses leveraged as a result of both the sales increase compared to last year and expense management. Overhead, store, and marketing expenses decreased significantly as a percentage of net sales, and were partially offset by an increase in bonus expense due to improved operating results.

Interest Income, Net. Interest income, net of interest expense was 0.1%, as a percentage of net sales for both of the six months ended July 31, 2010 and August 1, 2009.

Non-operating Income, Net. There was no non-operating income for the six months ended July 31, 2010. Non-operating income for the six months ended August 1, 2009 represents the realized gain related to the sale of preferred shares, partially offset by an other-than-temporary impairment related to auction rate securities.

Income Taxes. Our effective tax rate for the six months ended July 31, 2010 was 39.2%, compared to 39.8% for the six months ended August 1, 2009.

Net Income. For the six months ended July 31, 2010, net income increased 265%, compared to the six months ended August 1, 2009 and represented 6.2% and 1.9% of net sales for the six months ended July 31, 2010 and August 1, 2009, respectively. As a percentage of net sales, this increase was primarily the result of the increase in gross profit and the decrease in operating expenses.

Seasonality

Our business is subject to seasonal merchandise trends 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, 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 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 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 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.

Net Working Capital. Net working capital increased $39.4 million to $421.6 million as of July 31, 2010 from $382.3 million as of January 30, 2010, primarily due to the seasonal inventory increase, which was partially offset by a corresponding increase in accounts payable. As of July 31, 2010 and January 30, 2010, the current ratio was 2.9 and 2.7, respectively.

Operating Cash Flows. For the six months ended July 31, 2010, our net cash provided by operations was $18.4 million, compared to $36.4 million for the six months ended August 1, 2009. The decrease in cash provided by operations was primarily a result of increased inventory purchases and reductions in accrued expenses as compared to the prior year, offsetting the $38.9 million increase in net income.

Investing Cash Flows. For the six months ended July 31, 2010, our net cash used in investing activities was $71.1 million compared to $51.9 million for the six months ended August 1, 2009. During the six months ended July 31, 2010, we incurred $18.1 million in capital expenditures, of which $10.7 million related to stores, $4.0 million related to information technology and infrastructure and $3.4 million related to supply chain projects and warehouses.

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We expect to spend approximately $50 million for capital expenditures in fiscal 2010. 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 plan to open nine stores in fiscal 2010. During fiscal 2009, the average investment required to open a typical new DSW store was approximately $1.4 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 $0.7 million and new store advertising and other new store expenses typically accounted for $0.2 million.

Financing Cash Flows. For the six months ended July 31, 2010, our net cash provided by activities was $0.6 million. The increase was primarily the result of stock option exercises.

$100 Million Credit Facility. On June 30, 2010, the Company entered into a $100 million secured revolving credit facility (the "Credit Facility") with a term of four years that will expire on June 30, 2014. Under this facility, the Company and its subsidiary, DSW Shoe Warehouse, Inc. ("DSWSW"), are named as co-borrowers, with all other subsidiaries listed as guarantors. The Credit Facility may be increased by up to $75 million upon the Company's request and approval by increasing lenders and subject to customary conditions. The Credit Facility provides for swing loans of up to $10 million and the issuance of letters of credit up to $50 million. The Credit Facility is secured by a lien on substantially all of the personal property assets of the Company and its subsidiaries with certain exclusions and will be used to provide funds for general corporate purposes, to refinance existing letters of credit outstanding under the Company's previous credit arrangement and to provide for the ongoing working capital requirements of the Company. Revolving credit loans bear interest under the Credit Facility at the Company's option under: (A) a base rate option at a rate per annum equal to the highest of (i) the Federal Funds Open Rate (as defined in the Credit Agreement), plus 0.5%, (ii) the Agent's prime rate, and (iii) the Daily LIBOR Rate (as defined in the Credit Agreement) plus 1.0%, plus in each instance an applicable margin based upon the Company's revolving credit availability; or (B) a LIBOR option at rates equal to the one, two, three, or six month LIBOR rates, plus an applicable margin based upon the Company's revolving credit availability. Swing loans bear interest under the base rate option. The Company's right to obtain advances under the credit facility is limited by a borrowing base. In addition, the Credit Facility contains usual and customary 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, incur additional indebtedness, enter into transactions with affiliates, merge or consolidate with another entity, redeem our stock and pay cash dividends up to the aggregate amount of 50% of the previous year's net income, for a maximum of $50.0 million.

As of July 31, 2010, the Company had no outstanding borrowings and had availability under the facility of $72.2 million. As of January 30, 2010 under its previous credit facility, the Company had no outstanding borrowings and had availability under the facility of $132.6 million.

Contractual Obligations

We had outstanding letters of credit that totaled approximately $27.8 million as of July 31, 2010 under our current facility and $17.4 million as of January 30, 2010 under our previous facility. If certain conditions are met under these arrangements, we would be required to satisfy the obligations in cash. Due to the nature of these arrangements and based on historical experience and future expectations, we do not expect to make any significant payment outside of terms set forth in these arrangements.

As of July 31, 2010, 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 approximately $2.3 million as of July 31, 2010.

In addition, we have signed lease agreements for five new store locations expected to be opened over the next eighteen months, with total annual rent of approximately $5.2 million. In connection with the new lease agreements, we will receive a total of $3.1 million of construction and tenant allowance reimbursements for expenditures at these locations.

We operate all of 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 July 31, 2010 or January 30, 2010.

Off-Balance Sheet Arrangements

As of July 31, 2010, the Company has not entered into any "off-balance sheet" arrangements, as that term is described by the SEC.

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Proposed Accounting Standards

The Financial Accounting Standards Board ("FASB") 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 1 to the Condensed Consolidated Financial Statements for a discussion of the new accounting standards implemented.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our cash and equivalents have maturities of 90 days or fewer. At times, cash and equivalents may be in excess of Federal Deposit Insurance Corporation ("FDIC") insurance limits. We also have investments in various short-term and long-term investments. We have $1.0 million invested in certificates of deposit and participate in the Certificate of Deposit Account Registry Service®, which provides FDIC insurance on deposits of up to $50.0 million. Our available-for-sale investments generally renew every 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 income investments.

As of July 31, 2010, 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.

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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. When 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 these 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 the amount of potential liability could materially impact our future 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 30, 2010.

We plan to open nine stores in fiscal 2010 and plan to open ten to fifteen stores each year for the next three to five years, which could strain our resources and have a material adverse effect on our business and financial performance.

Our continued and future growth largely depends on our ability to successfully open and operate new DSW stores on a profitable basis. During fiscal 2009, 2008 and 2007, we opened 9, 41 and 37 new DSW stores, respectively. We plan to open nine stores in fiscal 2010 and plan to open ten to fifteen stores each year for fiscal 2011 and beyond. As of July 31, 2010, we have signed leases for an additional five stores opening in fiscal 2010 and fiscal 2011. During fiscal 2009, the average investment required to open a typical new DSW store was approximately $1.4 million. This continued expansion could place increased demands on our financial, managerial, operational and administrative resources. For example, our planned expansion will require us to increase investments in management information systems and distribution facilities. These increased demands and operating complexities could cause us to operate our business less efficiently, have a material adverse effect on our operations and financial performance and slow our growth.

Restrictions in our secured revolving credit facility could limit our operational flexibility.

We have a $100 million secured revolving credit facility with a term expiring June 2014. Under this facility, we and our subsidiary, DSW Shoe Warehouse, Inc. ("DSWSW"), are named as co-borrowers. This facility is subject to a borrowing base restriction and provides for borrowings at variable interest rates as defined in the agreement. The credit facility is secured by a lien on substantially all of our and our subsidiaries' personal property assets with certain exclusions and will be used to provide funds for general corporate purposes, to refinance existing letters of credit outstanding under our previous credit arrangement, to provide for our ongoing working capital requirements, and to make permitted acquisitions. The credit facility provides for a sub-limit to foreign borrowers that could subject us to foreign currency rate risk. In addition, the 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, limit or restrict our ability to grant liens on our assets, incur additional indebtedness, pay cash dividends and redeem our stock, enter into transactions with affiliates and merge or consolidate with another entity. These covenants could restrict our operational flexibility, and any failure to comply with these covenants or our payment obligations would limit our ability to borrow under the secured revolving credit facility and, in certain circumstances, may allow the lenders thereunder to require repayment.

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 July 31, 2010. There were no repurchases of shares to satisfy tax withholdings of stock option exercises.

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, up to the aggregate amount of up to 50% of the previous year’s net income, for a maximum of $50.0 million, provided that we meet the minimum cash requirement set forth in our facility.

Item 3.	Defaults Upon Senior Securities. None.
Item 4.	Removed and Reserved.
Item 5.	Other Information. None.
Item 6.	Exhibits. See Index to Exhibits on page –24.

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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:	September 1, 2010	By:	/s/ Douglas J. Probst Douglas J. Probst Executive Vice President and Chief Financial Officer (principal financial and accounting officer and duly authorized officer)

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INDEX TO EXHIBITS

Exhibit Number	Description
10.1	$100,000,000 Revolving Credit Facility Credit Agreement, between DSW Inc. and DSW Shoe Warehouse, Inc., as the Borrowers, and PNC Bank, National Association., as Administrative Agent, PNC Capital Markets LLC, as Sole Book Runner and Sole Lead Arranger, Bank of America, N.A, as Syndication Agent and Documentation Agent, and Fifth Third Bank and Wells Fargo Retail Finance, LLC as Managing Agents. Incorporated by reference to Exhibit 10.1 to DSW's Form 8-K (file no. 1-32545) filed July 6, 2010.
10.2	Summary of Director Compensation * #
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

* Filed herewith.

Management contract or compensatory plan or arrangement.