

## Best Buy Co., Inc. (NYSE:BBY)

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### Important Company Financial Data

Current Stock Price: 24.13

52-Week Range: 11.20-26.29

Market Cap: 8.17B

EPS: -1.32

Beta: 1.47

	48 weeks ending 2/2/2012	53 weeks ending 3/3/2012	52 weeks ending 2/26/2011	52 weeks ending 2/27/2010
Revenue	45,085.00M	50,705.00M	49,747.00M	49,243.00M
Gross Profit	10,650.00M	12,592.00M	12,550.00M	12,042.00M
Operating Income	-125.00M	1,085.00M	2,374.00M	2,368.00M
Diluted Normalized EPS	1.14	-0.64	3.68	3.36

### Thesis

Upon consulting with various analysts who cover Best Buy, it is extremely interesting just how deviating their opinions are. Consider that the price targets vary from 9.00 to 36.00 and recommendations range from strong sell to strong buy. Regardless, I recommend initiating a short position in Best Buy because of their high levels and wide variety of competition, current unjustified investor optimism, lack of product demand in the pipeline, decline in sales in several key categories, huge susceptibility to online competition, and inability to drive down costs while maintaining sales. I recommend a long-term short position, as according to Steve Cuolombe, Senior Managing Director at FTI Consulting, Best Buy will not last more than three years.

### Key Points

- Best Buy has reported a decline in financial performance and key financial fundamentals over the past few years. Fundamentals are moving in the wrong way in comparative years. Consider the negative operating income recorded in the last year. This contrasts with the huge jump in stock price, currently trading close to its 52-week high. Also, consider that after Circuit City filed for bankruptcy, most of their sales migrated to players other than Best Buy, whose top line remained roughly the same.
- Best Buy faces incredibly intense and diverse competition. It faces agnostic demand, meaning that its sells products that can easily be sold by many other competitors. Two of the only factors keeping Best Buy competitive are its relationships with many brands and market presence, according to an analyst at Janney Montgomery Scott. According to Scott Tilghman, Senior Analyst of Consumer Hardliners at B. Riley & Co., Best Buy's competitors are "literally everyone." By this he means that a consumer can buy the products that Best Buy sells at mall boutiques consumer electronics retailers, including vendors who offer their products direct to the consumer, internet-based businesses, wholesale clubs, discount chains and home-improvement superstores.
- An analyst I have spoken to at a major Swiss bank (who wishes to remain anonymous) believes that the significant rise in share price is related directly to investors "warming up to the story" of new management and potentially game-changing ideas. However, neither he nor I believe that this "warming up" corresponds to a real change in fundamentals or a strong enough strategy to combat Best Buy's several pressing threats. Steve Coulombe's experience with Big Box retailers is that their management never "does anything dramatic enough to turn the business around" and that it will "take a bankruptcy to fix Best Buy."
- There is not a great product demand cycle on the horizon. Best Buy will be very reliant on back-to-school sales.
- Moreover, the tremendous shift in media to online, easily downloadable forms has driven down Best Buy media sales. There has been tremendous sales decline in several key categories including DVDs, CDs, and videogames. The latter is due to the extremely long product cycle of videogame consuls. Similarly, analysts I have spoken with believe that the new consuls (skeptically believed to be released this year) will lose many casual gamers, as they would prefer to simply download games as applications, rather than buying new consuls and new physical games. Furthermore, compared to 8-10 years ago, there are and will be a continued decline in camera, phone, and GPS sales as these products have been consolidated into cheaper and cheaper smartphones.
- Consumer electronics have been so commoditized and branded that there has been a profound shift in buying habits towards online purchases. The aforementioned anonymous analyst believes that consumer electronics are the "retail category most susceptible to ecommerce." Moreover, because online retailers can avoid sales tax, the prices online are often lower than they are at Best Buy stores. Finally, it is simply more convenient to order products online from the comfort of one's home.
- "Showrooming" is a retail phenomenon that has caught some media attention in the last year. This entails consumers going to traditional brick-and-mortar vendors simply to try out and test products, but then return home to buy the very same products online, conceivably for a more competitive price. Some believe that this phenomenon has been blown out of proportion. However, consumer electronics is the industry that is the most susceptible. This is because, according to Tilghman, "consumers are much more comfortable buying these products site unseen." Simply, they do not need to go into a traditional store to test out products as much as one would with another kind of product, say a sporting good or home improvement item.
- Best Buy faces increasing cost-related problems. It is very hard to compete with online retailers who do not have any costs

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associated with big-box retailers. The fundamental cost problem is related to real estate. They have too many stores and their stores are too big, according to Steve Coulumbe. Moreover, as media sales declined, Best Buy has been trying to fill their stores with products that do not sell as well. Best Buy cannot simply close stores because they are completely integrated with Best Buy's strategy and competitive advantage. They also do are required to finish their lease agreements and do not have the capital to negotiate shorter lease terms. Moreover, it is often overlooked that huge cost drivers like rent and employee salaries are essentially connected to sales. Decreasing costs will inevitably decrease sales. It is very doubtful that Best Buy could recapture lost sales online.

### **Misperception**

- The misperception that showrooming is an overblown phenomenon or even that showrooming is an advantage: consumers will use Best Buy's physical stores to test out products, and then shop for them online. This model works with companies such as Apple and Warby Parker as they are selling their own products, not vending products from other producers. There is nothing to stop a customer from testing a tablet at Best Buy and then buying it for a more competitive price from an online retailer like Amazon.
- The misperception that financial fundamentals do not matter as Best Buy's new management will be able to implement transformative strategy.
- The misperception that the combined store/online model will be able to compete with online-only retailers by providing certain features only available at physical locations like same-day pickup, returns, and the ability to test products.
- The misperception of Best Buy's unique ability to sell the "latest and greatest" products. The reality is, a consumer can get almost any product online if he/she choses.

### **VAR**

- Scott Tilghman, Senior Analyst at B. Riley & Co. - covers Best Buy personally
- Analyst, Janey Montgomery Scott - covers Best Buy personally
- Analyst at a prominent Swiss Bank - covers Best Buy personally
- Steve Cuolombe, Senior Managing Director at FTI Consulting - expert in restructuring and finance, and particular experience with Best Buy (worked very closely with former owner Brad Anderson), Circuit City, and Borders

### **Risks / What Signs Would Indicate We Are Wrong?**

- Best Buy maintains great brand awareness, market presence, and familiarity. Moreover, they truly do carry the widest variety of consumer electronics of all compatible retailers. They present a challenge to their competitors with their broad lineup, brand standard. This could continue to maintain Best Buy's performance.
- Best Buy has started to implement increasingly competitive pricing. If they can maintain lower, or at least as low of prices as online retailers, they may be able to compete.
- It will be interesting to see whether consumers really do need face-to-face sales assistance in the consumer electronic sector. Trends seem to say no, but the increase in complicated technologies and competition from electronics producers may influence this debate. Moreover, some believe that there is still an advantage of being able to interact with certain electronic products in the store.
- As economic worries over the perceived "Fiscal Cliff" dwindle, there is a potential upside in consumer electronic sales.
- Best Buy's recently hired upper management, including the new CEO Hubart Jolly and CFO Sharon McCollam, has a good track record at similar brick-and-mortar vendors. If they can properly execute an innovative strategy, stock has potential to rise. For example, the new management has announced plans to leverage Best Buy's loyalty program users, which happen to be the most numerous of any company in the industry. Best Buy might be able to drive sales by "suggesting" accessories to users who have recently purchased combatable products.
- Some states have begun to initiate online sales taxes, which could conceivably slow down the transition from traditional sales to online sales. Similarly, some companies have begun to set specific prices that their products must be sold for, which would make Best Buy's prices necessarily equal to any competitors. However, I doubt that this model will really take hold.
- The recently announced "Samsung Experience Shops", which will be very similar to Apple Stores except located inside Best Buy locations, could drive increased sales for Samsung products. There is also the potential for a similar model with other technology companies.

### **Signposts / Follow-Up**

- Key financial fundamentals (Q1 2014 earnings release on May 21, 2013)
- End of Summer sales relating to back-to-school
- Best Buy's online versus traditional sales
- Samsung Experience Shop sales
- Number of physical locations closed
- Perceived effectiveness of new management

### **Company Description**

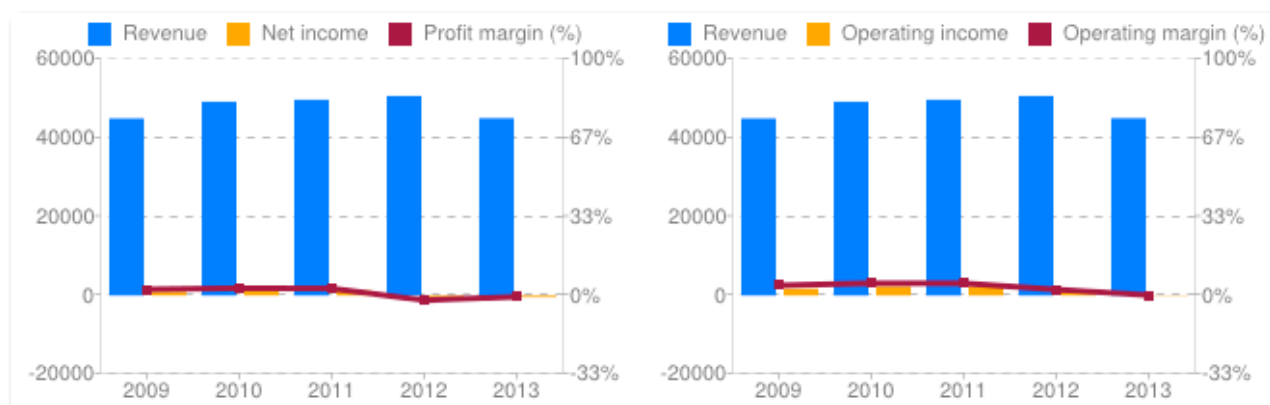
BBY is a multi-national, e-commerce and physical retailer of consumer electronics, including mobile phones, tablets and computers, large and small appliances, televisions, digital imaging, entertainment products and related accessories. BBY offers technology services – including support, repair, troubleshooting and installation – under the Geek Squad brand. BBY operates online retail operations, retail stores and call centers and conduct

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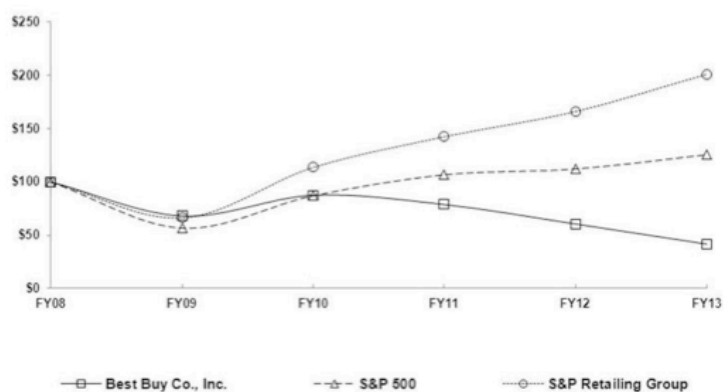
- Product offerings and prices of competitors
- Spread of online sales taxes

operations. (Best Buy 10K)

### Page of Exhibit(s)



### COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\* Among Best Buy Co., Inc., the S&P 500 and the S&P Retailing Group



\* Cumulative total return assumes dividend reinvestment.

Source: Research Data Group, Inc.

### Segment Information


	11-Month 2013	12-Month 2012	2011
<b>Revenue</b>			
Domestic	\$ 33,343	\$ 37,615	\$ 37,070
International	11,742	13,090	12,677
<b>Total revenue</b>	<b>\$ 45,085</b>	<b>\$ 50,705</b>	<b>\$ 49,747</b>
<b>Percentage of revenue, by revenue category</b>			
<b>Domestic:</b>			
Consumer Electronics	33%	36%	37%
Computing and Mobile Phones	44%	40%	37%
Entertainment	10%	12%	14%
Appliances	6%	5%	5%
Services	6%	6%	6%
Other	1%	1%	1%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>International:</b>			
Consumer Electronics	18%	20%	20%
Computing and Mobile Phones	61%	56%	55%
Entertainment	4%	5%	6%

\$ in millions, except per share amounts

(1) Fiscal 2013 (11-month) included 48 weeks and fiscal 2012 included 53 weeks. All other periods presented included 52 weeks.

Consolidated Performance Summary	11-Month		12-Month	
	2013	2012	2012	2011
		(recast)		
Revenue	\$ 45,085	\$ 46,064	\$ 50,705	\$ 49,747
Revenue gain (decline) %	(2.1)%	n/a	1.9 %	1.0 %
Comparable store sales % decline	(2.9)%	(1.6)%	(1.7)%	(1.8)%
Gross profit	\$ 10,649	\$ 11,352	\$ 12,573	\$ 12,541
Gross profit as a % of revenue <sup>(1)</sup>	23.6 %	24.6 %	24.8 %	25.2 %
SG&A	\$ 9,502	\$ 9,339	\$ 10,242	\$ 10,029
SG&A as a % of revenue <sup>(1)</sup>	21.1 %	20.3 %	20.2 %	20.2 %
Restructuring charges	\$ 450	\$ 34	\$ 39	\$ 138

## Best Buy Co., Inc. (NYSE:BBY)


**BEST BUY**

**Best Buy Co., Inc.**  
**Continuing Operations Store Count and Future Footage**

	Fiscal Year													
	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
<b>Number of Stores</b>														
U.S. Best Buy Stores <sup>(1)</sup>	1,103	1,099	1,069	1,023	923	822	742	668	608	548	481	419	357	311
Magnolia Audio Video Stores	5	6	6	6	13	20	20	20	22	19	13	13	-	-
Pacific Sales Kitchen and Bath Centers	34	35	35	34	19	14	-	-	-	-	-	-	-	-
U.S. Geek Squad Stand Alone Stores	-	-	6	6	7	12	12	6	1	-	-	-	-	-
Best Buy Mobile Stand Alone Stores	305	177	74	38	9	5	-	-	-	-	-	-	-	-
<i>Subtotal - Domestic Segment</i>	<i>1,447</i>	<i>1,317</i>	<i>1,190</i>	<i>1,107</i>	<i>971</i>	<i>873</i>	<i>774</i>	<i>694</i>	<i>631</i>	<i>567</i>	<i>494</i>	<i>432</i>	<i>357</i>	<i>311</i>
Future Shop Stores	149	146	144	139	131	121	118	114	108	104	95	-	-	-
Canada Best Buy Stores	77	71	64	58	51	47	44	30	19	8	-	-	-	-
Best Buy Europe - Small Box	2,393	2,357	2,371	2,380	-	-	-	-	-	-	-	-	-	-
Five Star Stores	204	166	158	164	160	135	-	-	-	-	-	-	-	-
Best Buy Mobile Canada	30	10	4	3	-	-	-	-	-	-	-	-	-	-
Mexico Best Buy Stores	8	6	5	1	-	-	-	-	-	-	-	-	-	-
Best Buy Mexico Express	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Canada Geek Squad Stand Alone Stores	-	-	-	-	-	-	5	-	-	-	-	-	-	-
<i>Subtotal - International Segment</i>	<i>2,861</i>	<i>2,756</i>	<i>2,746</i>	<i>2,745</i>	<i>342</i>	<i>303</i>	<i>167</i>	<i>144</i>	<i>127</i>	<i>112</i>	<i>95</i>	<i>-</i>	<i>-</i>	<i>-</i>
<b>Total - Continuing Operations</b>	<b>4,308</b>	<b>4,073</b>	<b>3,936</b>	<b>3,852</b>	<b>1,313</b>	<b>1,176</b>	<b>941</b>	<b>838</b>	<b>758</b>	<b>679</b>	<b>589</b>	<b>432</b>	<b>357</b>	<b>311</b>
<b><sup>1</sup>U.S. Best Buy Stores by Box-Size</b>														
20,000	81	82	79	74	67	56	47	34	7	2	-	-	-	-
28,000	4	4	4	4	4	7	8	11	13	16	20	25	30	43
30,000	428	425	405	375	293	225	174	123	103	70	38	19	9	-
36,000	31	25	22	19	22	24	27	28	30	31	32	34	36	36
45,000	516	518	514	506	492	465	439	425	407	379	339	289	230	180
58,000	43	45	45	45	45	45	47	47	48	50	52	52	52	52
<b>Total - U.S. Best Buy Stores</b>	<b>1,103</b>	<b>1,099</b>	<b>1,069</b>	<b>1,023</b>	<b>923</b>	<b>822</b>	<b>742</b>	<b>668</b>	<b>608</b>	<b>548</b>	<b>481</b>	<b>419</b>	<b>357</b>	<b>311</b>
<b>Total Retail Square Footage (000s)<sup>(1)</sup></b>														
U.S. Best Buy Stores	42,413	42,388	41,334	39,856	36,686	33,319	30,610	28,260	26,421	24,243	21,599	19,010	16,205	14,017
Magnolia Audio Video Stores	68	78	78	78	151	242	242	242	277	238	168	168	-	-
Pacific Sales Kitchen and Bath Centers	876	944	944	917	647	502	-	-	-	-	-	-	-	-
U.S. Geek Squad Stand Alone Stores	-	-	12	12	14	22	22	11	1	-	-	-	-	-
Best Buy Mobile Stand Alone Stores	428	250	112	61	13	8	-	-	-	-	-	-	-	-
<i>Subtotal - Domestic Segment</i>	<i>43,785</i>	<i>43,660</i>	<i>42,480</i>	<i>40,924</i>	<i>37,511</i>	<i>34,092</i>	<i>30,874</i>	<i>28,513</i>	<i>26,699</i>	<i>24,481</i>	<i>21,767</i>	<i>19,178</i>	<i>16,205</i>	<i>14,017</i>
Future Shop Stores	3,944	3,864	3,818	3,713	3,485	3,223	3,168	3,048	2,910	2,782	2,468	-	-	-
Canada Best Buy Stores	2,432	2,250	2,049	1,887	1,694	1,571	1,475	1,009	677	221	-	-	-	-
Best Buy Europe - Small Box	1,499	1,463	1,438	1,430	-	-	-	-	-	-	-	-	-	-
Five Star Stores	7,539	5,931	5,718	5,892	5,808	4,542	-	-	-	-	-	-	-	-
Best Buy Mobile Canada	31	13	7	6	-	-	-	-	-	-	-	-	-	-
Mexico Best Buy Stores	407	327	265	72	-	-	-	-	-	-	-	-	-	-
Best Buy Mexico Express	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Canada Geek Squad Stand Alone	-	-	-	-	-	-	9	-	-	-	-	-	-	-
<i>Subtotal - International Segment</i>	<i>15,852</i>	<i>13,848</i>	<i>13,295</i>	<i>13,000</i>	<i>10,987</i>	<i>9,336</i>	<i>4,652</i>	<i>4,057</i>	<i>3,588</i>	<i>3,003</i>	<i>2,468</i>	<i>-</i>	<i>-</i>	<i>-</i>
<b>Total - Continuing Operations</b>	<b>59,637</b>	<b>57,508</b>	<b>55,775</b>	<b>53,924</b>	<b>48,498</b>	<b>43,429</b>	<b>35,526</b>	<b>32,570</b>	<b>30,286</b>	<b>27,485</b>	<b>24,235</b>	<b>19,178</b>	<b>16,205</b>	<b>14,017</b>

### Ideas For the Club

- More friendly to new members
  - Brief lectures at the beginnings of meetings by finance professors on financial basics
  - Optional 30 min classes of the same nature outside of meetings
  - Older members should be assigned to new members as designated advisors
- Increased recruitment
  - Increase presence of MII both inside and outside of McIntire
  - Take members in both fall and spring
  - Advertise the club
- Speaker series
  - Speakers in the finance world during meetings
  - Video-chats with speakers who cannot make it to UVA
  - Less for recruiting, more for education
  - Investors in interesting niche markets
  - Other ways to apply finance than investing
- Social Events

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- Food at meetings
- Associate team dinners
- Hangouts after meetings (cigars, drinks, etc.)
- General points
  - Better transparency and relationship between managers and members
  - Shorter pitches, more questions