



## ANALYST QUICK NOTES

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**Bed, Bath & Beyond Inc. (NGS: BBBY: BUY)**

**Target Price: \$65**

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### Previewing 4Q Earnings

- Bed Bath is scheduled to report 4Q earnings after the close of trading on Wednesday, April 6.
- The company will host a conference call at 5:00 that afternoon.
  - 800-447-0521

### What We Like

- Shareholder friendly.
- Battle-tested management.

### What Concerns Us

- Competition.
- Gross margin pressure.
- Potential for ongoing IT investments.

### Our Thesis

- We recommend Bed Bath as a relative value idea within our retail universe.
  - We recognize that margins have been declining and the market does, too.
  - Our thesis is that BBBY is relatively attractive based on:
    - Valuation ,
    - Profitability , and
    - Shareholder-friendly record of repurchasing shares.

### Keys to the Call:

- We believe the keys to the call are likely to be the following.
  - The outlook for comparable sales and the prevalence of coupons and discounts to drive sales.
  - We believe Bed Bath trades at a lower multiple than many peers because of concern that it has greater vulnerability to internet competition.
  - Any evidence that confirms or dispels that concern may send the shares lower or higher respectively.
- More specifically, we expect investor interest in the incremental profitability of e-commerce sales.
- Remember, BBBY reported 3Q and provided 4Q guidance on January 7.
  - This was after Christmas and after the most-important part of the quarter was in the books.
  - This should have given management decent visibility on 4Q
- Commentary on post-holiday consumer trends. BBBY's fiscal 4Q includes Feb.
  - BBBY faces competition from...
    - Williams-Sonoma,
    - Pier 1,
    - Wayfair,
    - Pottery Barn,
    - Macy's,
    - Home Goods chain that is owned by TJX.
  - ...and less directly from...
    - Amazon,
    - Wal-Mart,
    - Target,
    - Restoration Hardware.

### A Relative-Value Idea

- BBBY shares are trading at about 10-times trailing earnings.
  - Below the five-year average of 15.
  - The range is 9-21.
  - Retailers in our coverage universe trade at a median trailing multiple of 21.
  - We believe that BBBY shares are very attractive at the low end of the peer-group range.
- Bed Bath is trading at a lower multiple than:
  - Williams-Sonoma at 16, Home Depot at 25 and Lowe's at 23.
  - We believe discount reflects concerns that Bed Bath is vulnerable to online competition.
  - We believe that an improvement in comp trends could be a catalyst for a higher multiple.
- EV of 5.4x EBITDA.
  - Peer median is 11x.
- Shares are trading at an enterprise value of about 6-times trailing EBIT.
  - Well below the peer median of 13

### **Very Profitable**

- Bed Bath has an operating margin of 14%.
  - Peer median of 11%.
- ROE 30%
  - Peer average 19%

### **Shareholder Friendly**

- Over the last two years, the company returned approximately 90% of cash flow from operations to shareholders through its share-repurchase program.
- BBBY repurchased \$194 million of shares in 3Q.
- In the 2Q release, back in September 2015, the company announced a new \$2.5 billion repurchase program that will begin following the completion of the current program, which had a remaining balance of \$110 million at end of 3Q.
  - Probably repurchased remaining \$110 million in 4Q.
- Management expects to complete the new authorization in approximately four years.

### **Solid Balance Sheet**

- Bed Bath had about \$565 million in cash and investment securities at the end of the third quarter, or about \$3.50 per share.
- Our financial strength rating on BBBY is Medium-High, the second-highest rank on our five-point scale.
- Believe that Bed Bath's substantial profitability and cash generation give it the flexibility to finance its growth internally.
- Bed Bath has a BBB+- credit rating from S&P and a Baa1 rating from Moody's.

### **The Numbers**

- Our 4Q estimate is \$1.84.
  - Had been \$1.91 before 3Q release.
  - We reduced on a lower sales estimate and a bit more gross-margin pressure than we modeled previously.
  - Our hope is that the company now has fairly good visibility with the Christmas season already on the books. Fourth-quarter EPS guidance is \$1.72- \$1.86.
  - Consensus is \$1.81.
  - No significant move in consensus over last 4 weeks.
- EPS has only topped consensus in one of the last eight quarters. The shares are fairly volatile after earnings reports, with an average absolute price change of 5.7%. Based on trading in the options market, the implied price move is 5.8% following the 4Q release.

### **Recommendation:**

- Buy
- We remain confident in Bed Bath's battle-tested management team.
  - The company drove its closest competitor out of business. It also has successfully competed against Amazon as well as Wal-Mart, Target and the department stores for years.
- We are marginally more cautious because of internet competition and holiday shopping seasons that appear to be increasingly competitive.

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