

# [Bed bath and beyond essay](https://assignbuster.com/bed-bath-and-beyond-essay/)

Bed, Bath and Beyond Case Analysis 1. Study BBBY’s historical results in the “ Historical Performance” worksheet contained in the “ BBBY” EXCEL workbook. What overall conclusion about BBBY’s recent operating and financial condition do the numbers support? Back up your conclusion by listing the six most critical observations you discern from your analysis of the numbers. Conclusion: BBBY is a home goods industry leader in sales growth, margins and return on equity. The company continues to generate excess cash through profitable operations despite large capital expenditures for growth.

The company needs to create a plan to invest their excess cash to optimize company results and increase shareholder value. Observation#1: Return on Equity (ROE) is very strong at 49. 9% which is entirely attributable to their Return on Invested Capital (ROIC). Since BBBY has not financed the business with any debt, the ROIC equals ROE. However, these returns are negatively impacted by the large balance of non-operating assets (i. e. marketable securities) because they are not offset against any non-operating liabilities.

The combination of Return on Net Operating Assets (RNOA) with negative financial leverage and the spread has resulted in lower ROE. #2: BBBY has $400M excess of Cash and Marketable Securities than needed for planned growth and operations. Holding excess cash during periods of declining interest rates will have a negative impact on returns. #3: BBBY has created profitable strategies that result in high Profit Margins: \* Decentralized product mix decisions to store leaders to carry profitable, high volume products that local consumer demand. \* Private-label items hat provided value based goods to consumers with high margins for BBBY. \* Everyday low pricing strategy with markdowns only for excess inventory of discontinued items \* Cost conscious culture that resembles Walmart \* Low advertising costs; low cost mailers and referrals to generate awareness #4: Small increases in Net Operating Working Capital change despite large investment in store growth over time. BBBY has been successful in increasing their payment deferral period to offset increases in inventory and other current assets needed for growth. #5: The firm has steadily increased Free Cash Flows from pure business operations.

In the past three years, BBBY has generated significant free cash flows despite large capital expenditures for store expansion. #6: BBBY has generated significant Market Value Add (MVA) and Economic Value Add (EVA). BBBY appears to be an “ industry darling” as evidenced by their performance. Positive press coverage of these results has likely helped fuel the run up in their market price. The increased MVA indicates that shareholders have recognized past operating success and believe that the company has strong growth plans that will continue to add value in the future.

A strong EVA metric indicates that the return on invested capital has exceeded the cost of capital. 2. What might a major recapitalization of BBBY signal to investors? A leveraged recapitalization could signal both proactive (shareholder value returns) and reactive (takeover mitigation) strategies – \* The recapitalization would tell investors that BBBY wants to deliver value to shareholders while continuing to fulfill their commitment to invest in store expansion for future growth. The leveraged firm would provide greater returns to the shareholders by adding the value of the tax shield.

Additionally, the company would be taking advantage of current capital market conditions which present attractive debt financing options for strong, well-managed companies. The plan represents a prudent and efficient use of balance sheet capacity that would enable BBBY to continue generating sustainable free cash flow to meet their capital needs and growth objectives. \* The recapitalization would tell investors that BBBY is concerned about a hostile takeover so they added debt and eliminated excess cash. This approach also provides higher ownership and share of control to large shareholders.

These changes make takeovers more difficult and less attractive to prospective buyers. Regardless of approach, the large debt could be a strong motivator for management to continue to improve operational performance thus generating sufficient cash flows to pay their new obligations. 3. Assume M&M’s financial structure model (VL = VU + TC X VIBD – TC X VMS) holds and complete the cells that are shaded light grey in the “ Unfinished Recap Effects” worksheet. Turn in a copy of your completed worksheet and use the results to compare and contrast how BBBY’s issuance of $1. 3 billion in debt together with liquidating $0. 701 billion in marketable securities in order to pay a one-time dividend of $1. 731 billion or repurchase $1. 731 billion of shares would affect these items: Common shares outstanding Total capital was the same under both scenarios but a repurchase of $1. 731B of shares reduced common shares outstanding to 252. 845 and increased the price per share. However, the one-time dividend kept the total number of shares constant and reduced the price per share. Book value per share

On the share repurchase option, the book value per share was reduced to $1. 02 as a result of a lower number of shares and lower common stock equity. However, the book value per share was reduced to $0. 87 for a one-time dividend scenario because the total number of shares stayed constant and common stock equity was reduced. Common stock price per share Total capital was the same under both scenarios but a repurchase of $1. 731B of shares reduced common shares outstanding and increased the price per share from $37 to $39. 33.

However, the one-time dividend kept the total number of shares constant and reduced the price per share to $33. 50. In a successful recapitalization, the value of the dividend plus the value of the post-recap share should exceed the pre-recap share price. Book value leverage Book value leverage was identical for both scenarios because interest-bearing debt and total capital values are equal. Market value leverage Market value leverage was identical for both scenarios because interest-bearing debt and total capital values are equal. Shareholder wealth

Absolute shareholder wealth is equal under both scenarios. However, shareholder wealth per share is higher for the repurchase option because BBBY has fewer shares outstanding. Voting control Voting control changed for the repurchase option because BBBY bought the shares back from the open market. As a result, it reduced control from “ Others” but increased control for Officers and Directors, Prudential and AXA Financial. This could provide more influence to Prudential or AXA Financial to change board of directors so it could be a risk. However, voting control did not change for a one-time dividend option. 4.

The table below lists some of the qualitative risk factors that a potential creditor might examine in judging BBBY’s overall business (operating) risk. Please complete it. BusinessRisk Factor:| Circle One:| Comment:| Brand name andmarket position| Low RiskModerate RiskHigh Risk| BBBY was the largest big box domestics retailer despite having only 4% market share. Consumers appreciated excellent client experience while analysts valued their consistent sales/earnings growth. | Business Model| Low RiskModerate RiskHigh Risk| Aggressive growth strategies aligned with store expansion and same store sales increases.

Strong historical trends of executing expansion strategy increases the likelihood of success. | Cyclical natureof business| Low RiskModerate RiskHigh Risk| Business is cyclical with the highest sales coming in August, November and December while lowest in February and March. However, it is less seasonal than for many other competitors. Q1 cash flows may have more risk. | Productdiversification| Low RiskModerate RiskHigh Risk| Broad merchandising offering (30K SKUs), however, it was focused on domestics and home furnishings.

Market changes in new home sales, weddings, college enrollment & general economy could impact future growth. | Geographicaldiversification| Low RiskModerate RiskHigh Risk| Geographically decentralized in 629 stores in suburban areas of medium to large cities. Future growth will be in both new and existing markets. Market disruptions in specific locations mitigated across large footprint. | Tangible assetsavailable forloan security| Low RiskModerate RiskHigh Risk| Besides cash, most of BBBY assets are tied up in inventory and PP&E.

These assets are tangible but would provide minimal security on the loans because they would be sold for much less than current value. | 5. Use the information in rows 120 – 134 of the projection worksheets to assign a bond rating to BBBY if it were to complete the $1. 731 billion leveraged recapitalization. Provide a complete rationale for what you assign. We would assign a bond rating of Aa3 (Moody’s) or AA+ (S&P, Fitch) to reflect that the company has strong cash flows to meet its financial commitments.

BBBY sales and income ratios are significantly better than industry averages and demonstrates high times-earnings-interest ratios. However, our analysis is concerned with the high book value debt ratios that include long term debt and large operating lease commitments. These debt commitments demonstrate that BBBY is vulnerable to market downturns or other business risks. This concern is somewhat offset by the lower market value debt ratios so our credit analysis would classify BBBY with a strong investment grade rating. 6.

Please take the perspective of a potential creditor. Study the two projection worksheets carefully in order to determine what conclusions a creditor might draw from it about BBBY’s ability to service the $1. 03 billion debt load and the risk such a creditor would be taking if it participated with other lenders in providing the loan. List and briefly explain what you deem to be the four most important observations a potential creditor might make in this respect. Observation#1: BBBY is forecasting a strong likelihood to generate Free Cash Flows.

Specifically, the Cash Flows available to all investors more than covers interest and mandatory debt retirement as evidenced by high multiples for interest coverage ratios. #2: BBBY balance sheet has a conservative philosophy, no long-term debt obligations and strong capital position. Potential creditors would inquire to whether the payment deferral periods have been negotiated to 70 days and that BBBY has strong credit history of paying their vendors timely. These factors demonstrate a company which has strong character to meet any future debt obligations. #3:

BBBY has a successful business model with double digit sales growth since 1997. Their leadership team has a solid track record with a strong business plan for the future. Operational risk factors (i. e. downturn in economy) could be mitigated by reducing capacity for investments and sales growth assumptions and BBBY could still pay debt obligations. #4: The ability to secure collateral for the loan would be limited to inventory and equipment. Creditors could not use real estate or accounts receivable as collateral because BBBY leases it space and does not hold AR on the books (retail sales only).