

Bed bath and beyond financial ratios essay

[Business](#), [Decision Making](#)



The success of the superstore format allowed BABY to issue its PIP in June 1992. Since then, BABY has continued to grow by opening new stores, expanding existing stores and adding additional square feet of retail space. Their growth had a positive impact on sales & net profit & their stock price has sky rocketed & increased by over 350%. However a troubling reality is that over the past 4 years Baby's sustainable growth rate has been declining. BABY is at an inflection point where the sustainable growth rate is not aligned with the growth strategy.

It is our recommendation that BABY improves their sustainable growth rate by increasing leverage in the near term while anointing to improve their asset turn ratio in the mid and long term. Market & Competition The home furnishing industry can be roughly categorized into two segments: \$15 billion for home textiles & \$30 billion for housewives/tabletop. Both these segments are highly competitive, in the home textiles segment top ten retailers have approximately 65 percent of the market share where as in the house wares segment top ten retailers constitute 45 percent of the market. Competitors used different business formats, which could be roughly divided into five categories: departmental stores, discount stores, specialty stores, actors outlets & superstores. BABY competed With companies operating in each of the above formats.

However, its main competitors were other Superstores & specialty stores moving toward the superstore format. Mainly operators like Strode, Lechers, J. C. Penny, Linens ' n Things, Home Express, Homepage, Pacific Linens, Luxury Linens, Linen Supermarket, LeeJay, Home Goods, TXT & Burlington Coat Factory. Bed, Bath & Beyond Strategies Business Strategy While the <https://assignbuster.com/bed-bath-and-beyond-financial-ratios-essay/>

superstore format may be distasteful to urban planners, it is gold for Bed, Bath & Beyond. It allowed them to deliver outstanding value to their customers & shareholders by reducing distribution overhead, offering its customers depth and breadth of products, and generating high per store sales volumes.

The move to the superstore format allowed BABY to fashion itself as a one-stop shop where customers know they will find quality merchandise at everyday low prices. Baby's superstores averaged 40, 000 square feet thus allowing them to carry 30, 000 stock keeping units (SKI-IS) stocked from floor to ceiling and displayed both branded and private-labeled in a variety of colors, styles or sizes of a particular item. Baby's policy of not using warehouses and shipping all inventories directly to the store ensure that merchandise is always in stock. BABY superstores are organized into 11 'specialty stores' along a 'racetrack' layout with fixtures & signs throughout the stores to direct customers to the desired section(s). The 'racetrack' layout also encourages customers to shop the entire store. BABY prices their items 20%-40% below departmental store prices. Their use of everyday low pricing gives their customers confidence to not "wait for sales". BABY obtained best prices on merchandise through their central buying office, hence allowing them a higher than usual margins on their inventory items.

BABY maintained a low expense structure because they didn't use warehouses, spend little on advertising, were located in low-cost strip malls and had a lean corporate organization. The corporate buying staff would place initial inventory orders for new stores and first-time orders for new

items. New stores were supported with corporate generated advertising & promotions until they became established in the market. A series of sound decisions that leverage economies of scale & lower operating costs.

Operating Strategy Bed, Bath and Beyond (BABY) operating strategy is to develop an entrepreneurial culture; store managers are encouraged to adjust the merchandising mix to suit local markets tastes. They are responsible for monitoring stock levels & re-ordering merchandise as necessary from the 160+ suppliers.

BABY employs the use of markdowns to dispose of slow moving inventory that was going to be discontinued. They train employees to be knowledgeable about the merchandise and to assist customers in making decisions. A wide range of options to choose from combined with expert sales device enables customers to find most (if not all) items they need in a single visit. Checkout lines are continuously monitored to minimize wait-times, and customers can return most items without a sale receipt if they later changed their mind or needed a replacement Thus, their operations improved the overall shopping experience of the customer by making it efficient & hassle free. BY prefers to lease their sites and superstores. This is in accordance with their practice of maintaining a low expense structure.

BABY carries quality name brands such as Fielders, Laura Ashley, and Rubberier. If branded manufacturers do not allow heavy discounting on their brands, BABY does not carry those products, but rather replaces them with comparable merchandise. Store managers are trained to sell high-margin products (store managers also spend time on the sales floor leading and

training employees). These factors contribute towards their stronger than sector gross profit margin in year 1 994' BABY had a Gross Profit Margin of 41.

% (see Appendix). Baby's control over operating expenses allowed them to sustain and lead their segment with 12% year over year operating profit argil (while opening new stores). Expansion Strategy BABY transitioned from a privately held S Corporation to a publicly traded company and at the same time expanded tremendously. Its finances changed dramatically over a relatively short period. As part of the PIP, the company raised over \$MOM in capital but the vast majority, \$29. MM, was distributed to the two owners Feinting and Ginsberg.

While much of the expansion could be funded organically through the existing profitable stores, the overall pace of expansion was much faster. To close the gap BABY acquired a revolving line of credit. While this instrument provides a significant amount of flexibility, it was limited to \$MOM and was a revolving debt not a long-term debt. BABY planned to open eight new stores in 1994 and 15 new stores in 1995. To support their expansion plan and existing operations, BABY plans to use a mix Of operating cash and revolving credit. However in 1 994, as the debt funded expansion was taking place, asset turnover took a concerning dip (Figure 2).

This caused inventory' to rise to even higher levels than would be expected for the expansion alone. Eventually this led to a situation where cost of the companies cash was depleted, either tied up in inventory or put toward

expansion. In a single year, from 1993 to 1994, the quick ratio dropped from 0.52 to 0.

09. This is a serious concern as, for most businesses; this would be an existential threat to their ongoing operations. There is some relief because BABY is a retail company doing 4-5 turns a year, so their inventory is more liquid than many other businesses, but still great reason for concern. This solvency issue puts Baby's expansion strategy very much at odds with its historic choice to fund growth organically or through revolving credit.

As the number of stores being opened increases, so too will the demand for capital. Given the current financial picture, all indications are that BABY will find its growth limited by lack of available capital. The revolving credit facility does offer an easy method of obtaining some relief, but it is already being heavily drawn upon. A potentially more attractive alternative would be to obtain longer term financing through bond issuance to allow financing over a longer horizon, with future obligations more predictable so that an increase in interest rates does not derail their entire expansion plan. Are these strategies working? Comparison with competition A comparison of Buys (with competition) year over year same-store sales, sales per square foot and square footage expansion plans shows that BABY is ahead of its competition. Year-On-Year (YOU) same-store sales BABY YOU sales are up by 10.6% across its 45 stores.

Astounds and Lechers are lagging at near flat YOU same-store sales. J. C. Penny a national chain department store competes with BABY at 9.7% YOU

sales. This is a good indicator that BABY is doing a great job in acquiring & sustaining its market shares.

Sales per Square Foot At \$232/square foot, BABY is in the middle of the pack among their competitors. But sales per square foot don't tell the whole story. Astounds generates more sales/square foot, but has smaller stores that do less volume. Each BABY store generates nearly xx sales of a Astounds store. To outpace Astounds grab for market share, BABY needs to open half as many stores. From an operational perspective, given the baseline requirements of opening any one store, this should be a big advantage: Fewer human resources, fewer distribution points, and fewer marketing efforts to generate the same volume of sales. Lechers has 1.1 x as many stores as BABY, but on average, their stores generate only 0.5 of the sales that BABY stores generate. BABY per store sales volume will enable it to eclipse Lechers market share.

The BABY superstore model puts it in a great position to capture market share from traditional smaller stores via store expansion; the department stores present a more formidable challenge. With 1,266 stores, J. C.

Penny has a national footprint and xx as many stores as BABY. Each store generates over xx the sales of a BABY store. However, their sales span a number of different categories. Sliding ROE (Explanation using Dupont Analysis) While many companies develop a core competency that makes them great in their field, BABY is a leader in multiple facets of the Dupont Analysis. This dominance has driven Baby's superior ROE and fueled the phenomenal growth the company has experienced. However, there are

significant reasons for concern, as the company's performance has been steadily declining, as shown in the chart below. Figure 1 Understanding this decline requires looking at each of the constituent factors, as detailed in the following table. Metric 1991 1992 1993 1994 Profit Before Taxes/Sales (%) 2.

87% 11 . 89% 12. 27% 12. 08% x Sales/Average Assets 3. 85 3. 65 3.

28 3. 09 x Avgas. Assets/Average Equity 1 . 79 1 . 68 1 .

55 1 . 50 X(l-rag Rate) 0. 0 0. 59 = ROE (96) 53. 12% 43. 85% 37. 34% 33.

18% x (1 -Dividend payout Ratio) = Sustainable Growth Rate (96) Figure 2 - DuPont analysis for BABY over time The most significant area that BABY has owned an edge is in the net margin where Baby's 12. 08% leads the field by a wide margin, with J Penny the closest competitor at 7. 94% and other specialty stores well behind. This net margin advantage is driven both by their focus on higher margin segments UT also by their operational efficiency. Choices such as shipping merchandise direct to store has allowed them to cut overhead.

At its current size, BABY also has an advantage that they can be more selective with their choice of locations, choosing only the very most lucrative. Again, the direct to store merchandising strategy aids in this pursuit by giving the company the freedom to place stores in prime locations without need for a distribution network. While there has been variation in this number, overall their net margin performance has remained fairly consistent, which is a positive indicator.

Buy's asset turnover has shown a concerning decline, but currently also stacks up very favorably against the competition at 3.09 versus 2.7 for Astounds, the nearest competitor, and ratios below 1.

5 for the rest of the field. This is reflective of both Buys higher than average rate of inventory turnover, but also of their strategy to lease store locations rather than buy, reducing their asset burden. This latter factor is perhaps the differentiator between BABY and J Penny, which has higher inventory turnover but an asset turnover ratio less than half of BABY.

Another possible actor, BABY has no accounts receivable whereas J Penny has an average receivables payment time of 78 days, quite possibly an indication that they offer a store card or other form of credit. Providing such interest free loans can become a major drain on profits as well as creating an additional large asset overhead on the balance sheet, and BABY has done well to avoid it. However, the declining trend in this metric, down 20% between 1991 and 1994, is a major driver of their overall decline in ROE. While there are several potential contributing factors, from the macroeconomics of home ownership to the lifestyle of stores as they age or even possibly difficulty finding sufficient management talent to scale, undoubtedly this is a key issue for BABY to address in order to continue expanding successfully. Finally, BABY's Asset/ Equity ratio is the lowest in the field, and has actually shrunk over time, indicating a very modest amount of leverage used to finance the business. This is driven by Baby's choice to fund growth organically, as well as their lower asset levels described previously. While this lowest leverage ratio is a positive indicator for their

overall financial health, given their growth ambitions, this may represent an area of opportunity for the company to unlock greater returns. Their reduction in leverage by 20% from 1991 to 1994 has also been a significant contributor to the decline in ROE.

However, it is one that the company has greater control over in the decision making process. By judiciously taking on additional leverage, BABY can continue expanding into new markets before competitors have time to adapt their own operational models to better compete with Baby's model. By moving the leverage ratio from 1.5 up to 2, the company could potentially reverse the declining trend in ROE and raise it from 33.8% to 44.18% while still remaining near the low end of the industry in leverage use.

Performance ratios: How has BABY fared over time?