

## Bed Bath & Beyond (BBBY)

**Business Description:** Bed Bath & Beyond Inc., together with its subsidiaries, operates a chain of retail stores. It sells a range of domestics merchandise, including bed linens and related items, bath items, and kitchen textiles; and home furnishings, such as kitchen and tabletop items, fine tabletop, basic housewares, general home furnishings, consumables, and various juvenile products.

**Thesis:** Short-term investments and restructuring costs hide the earnings power of BBBY's core businesses in home, beauty, and baby. The company is in the process of selling off non-core assets and using that cash to reinvest back into these core business lines. The stock's down 60% since the COVID-19 crisis. At its current price, you can buy BBBY for ~2x cash flow.

The company's balance sheet is strong. They have \$1.4B in cash against \$1.44B in long-term (low interest) debt. Management said their plan is to return money to shareholders in droves. We see this from three avenues: debt reduction, buybacks, and dividends. BBBY's future core businesses will look nothing like its past as the company migrates more of its sales to its omnichannel platform.

Over time, this should increase EBITDA margins and free cash flow. If management executes, we see a path towards \$295M in NOPAT by 2025 and \$700M in EBITDA. This would give us a shareholder equity value north of \$10/share assuming a median 7-8x EBITDA multiple.

Finally, BBBY has an anchor investor in Legion Partners. Legion's an activist, deep-value oriented investment shop dedicated to finding and investing in turnaround situations.

### The Turnaround Story: Management's Plans

Turnarounds are tough. They seldom work. But when they do, they're **very rewarding** to patient shareholders. BBBY management outlined their turnaround plan in their letter to shareholders (you can read it [here](#)). Operational transformation takes three forms:

1. Stabilize & Drive Top-Line Revenue Growth
2. Resetting Cost Structure
3. Reviewing & Optimizing Asset Base

They also hired a new CEO, Mark Tritton, and revitalized the board. This is Tritton's first shot as CEO of a public company. He held roles at Target, Nordstrom, and other companies. These are obvious strategies for nearly all turnarounds, but let's see how BBBY plans on fulfilling these goals.

#### Stabilize & Drive Revenue Growth

BBBY's driving revenue growth through physical store investment and rapid adoption of digital/omnichannel commerce platforms. These investments will cost millions of dollars, distorting short-term free cash flow.

The physical store upgrades will take years to complete, and the benefits won't be immediate. Yet it's the digital channel that gets me excited about BBBY's future. The company's growing their digital platform 30% annually. As BBBY moves more of their sales online, they'll receive higher average margins and greater cash flow.

## Resetting Cost Structure

The company's slashing expenses via operating sale-leasebacks and reducing overhead. BBBY completed its sale-leaseback transaction in Q3, receiving around \$250M in cash. They also fired 7% of their corporate staff and outsourced various transaction processing services (another 80 positions).

These efforts should result in roughly \$50M/year in run-rate cost savings. They've also slashed inventory levels, writing down \$509M in inventory reduction last quarter. This frees up more cash each year as BBBY operates a leaner, more efficient inventory management system.

Over time, these initiatives will improve gross margins, resulting in higher cash flow conversion.

## Selling Non-Core Assets

Along with reducing workforce and optimizing its physical stores, BBBY's selling non-core assets to fund core business growth. As an example, the company sold its One Kings Lane business for an undisclosed amount, as well as [PersonalizationMall.com](https://www.personalizationmall.com) for \$250M.

Over time we expect more sales of non-core assets with the proceeds reinvested into growing BBBY's online presence and physical store makeover.

## **Favorable Debt Structure & Cash Flow Positive**

BBBY has a very favorable long-term debt structure. The company pays roughly 4.50% on its \$1.44B in debt, with most of that debt coming due between 2034 - 2044. Plenty of time for BBBY to turn their business around and retire debt early (if they choose to do so).

Despite the large growth decline in net income, BBBY's been able to generate positive free cash flow each of the last five years. Even amidst massive investments in-store makeovers and digital channels, the company expects to remain free cash flow positive.

## **Large Growth in Digital Sales**

BBBY's shift towards digital sales is a key component to its turnaround success. So far BBBY's digital sales channel is killing it — of course, COVID-19 is driving a large portion of this so it'll be important to see what happens to growth once social distancing restrictions are lifted. Management affirmed this in their latest earnings call, saying (emphasis mine):

***"The Bed Bath & Beyond digital business is seeing net sales growth of more than 90% for the month of April to date, further strengthening our omnichannel strategic direction. This demand is being facilitated by our agile digital and marketing teams who are working together, responding to consumer data, creating newness and freshness across our sites, highlighting items customers need to make it easy to feel at home and communicating important information about changes in store hours and closures as well as safety measures so that our customers are clear on how we are operating and how they can shop with us."***

And here's management on their mobile sales growth:

***"Sales in our mobile channels for both Bed Bath & Beyond and buybuy BABY each grew more than 30% year-over-year in the fourth quarter, and orders taken through our mobile app were up over 75%. These quarterly results strengthened our resolve to continue to make necessary bold and broad-based changes needed to modernize our business and gives us confidence about our ability to improve upon this quarterly performance."***

## **Valuation: Stay Alive To Reap Rewards**

BBBY generates plenty of free cash flow. Last year they did over \$300M in free cash flow before interest expense.

Interest on debt knocks roughly 20% off FCF. So after interest, **true free cash flow** is around \$250M.

What would an optimistic scenario look like over the next five years? Our base model assumes the following:

- 20% decline in revenues in 2021
- 3% top-line growth from 2022 - 2025
- Gradual increase in EBITDA margin from 2.3% to 6.5% (digital providing higher % of sales)
- Capital expenditures at 4% of revenues
- 10% Discount Rate

Under these assumptions, we end 2025 with \$9.9B in top-line revenue, \$652M in EBITDA and roughly \$270M in NOPAT. Of course, the above scenario doesn't exactly "wow" investors. In turn, we'll have to lower our exit EBITDA multiple. If we apply an 8x multiple on 2025 EBITDA we get \$3.6B in Enterprise Value and \$1.23B in shareholder equity. That's roughly \$10/share, or 100% upside from the current price.

Again, that's assuming 20% reduction in next year's revenue and a **modest** 3% annual growth rate till 2025.

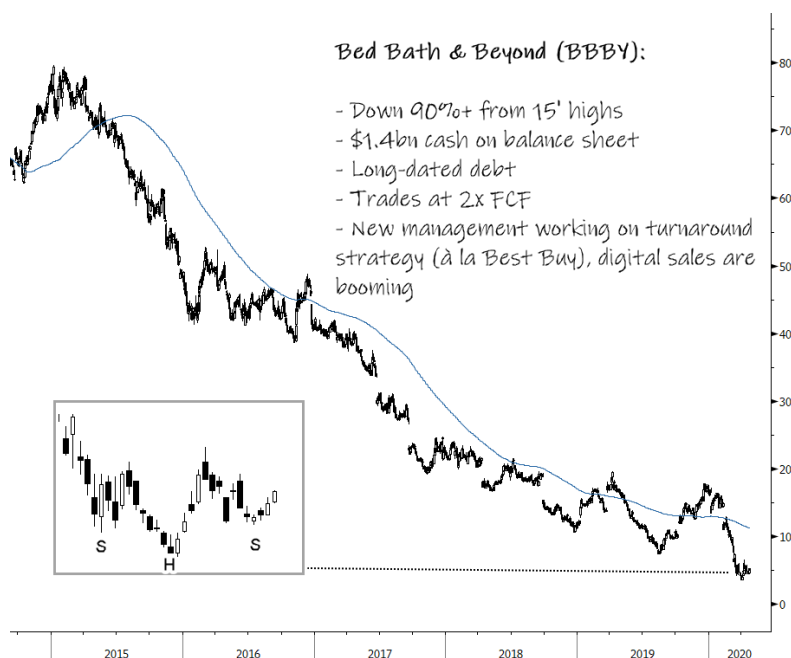
### A More Optimistic Approach: Online Sales Take Off

What if online sales continue to grow at a rapid pace? What if the store remodeling works? What would that do to top-line revenues? We could see mid-to-high single-digit revenue growth towards the end of the next five years. For the sake of simplicity, let's assume a gradual increase in top-line from 3% growth to 6% growth by 2025.

In this scenario, we end 2025 with \$10.5B in revenues, \$690M in EBITDA, and roughly \$290M in NOPAT.

Now, what multiple should a growing, online-centered, revitalized retail store command? 8 - 9x? An 8.5x multiple on 2025 EBITDA gets us nearly \$4B in Enterprise Value. Add back cash and subtract LT debt and you've got \$1.6B in shareholder equity, or \$13/share (127% upside).

### **Chart Set-up: Reversal Seen In Price Action**



BBBY is forming a near textbook inverse head-and-shoulders reversal pattern. A breakout above the horizontal resistance line would confirm the reversal of the current bear trend.