**February 28, 2014**
**Volume XL, Issue II**

# Bed Bath & Beyond Inc.

**Nasdaq: BBBY**

| | |
|---|---|
| **Dow Jones Indus:** | **16,321.71** |
| **S&P 500:** | **1,859.45** |
| **Russell 2000:** | **1,183.03** |
| **Index Component:** | **S&P 500** |

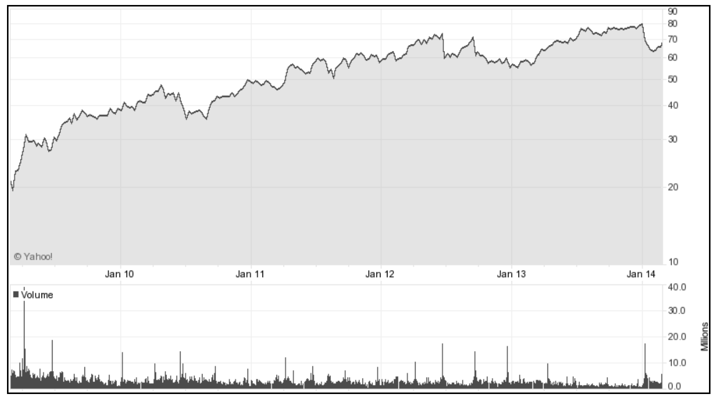
**Initially Probed: Volume XXXVIII, Issue VII & VIII @ $69.77**
**Last Probed: Volume XXXIX, Issue XI & XII @ $76.52**
**Trigger: No**
**Type of Situation: Business Value**

| | | |
|---|---|---|
| **Price:** | **$** | **67.82** |
| **Shares Outstanding (MM):** | | **209.7** |
| **Fully Diluted (MM):** | | **212.3 (1.2%)** |
| **Average Daily Volume (MM):** | | **2.6** |
| **Market Cap (MM):** | **$** | **14.2** |
| **Enterprise Value (MM):** | **$** | **13.4** |
| **Percentage Closely Held:** | | **Insiders ~4%** |
| **52-Week High/Low:** | **$** | **80.82/56.37** |
| **5-Year High/Low:** | **$** | **80.82/19.52** |
| **<u>Trailing Twelve Months</u>** | | |
| **Price/Earnings:** | | **13.8x** |
| **Price/Stated Book Value:** | | **3.4x** |
| **Net Cash & Investments (MM):** | **$** | **781** |
| **Upside to Estimate of Intrinsic Value:** | | **47%** |
| **Dividend:** | **$** | **NA** |
| **Yield:** | | **NA** |
| **Net Revenue Per Share:** | | |
| **LTM:** | **$** | **55.12** |
| **2012:** | **$** | **44.75** |
| **2011:** | **$** | **38.95** |
| **2010:** | **$** | **33.93** |
| **Earnings Per Share:** | | |
| **2012:** | **$** | **4.56** |
| **2011:** | **$** | **4.06** |
| **2010:** | **$** | **3.07** |

| | |
|---|---|
| **Fiscal Year Ends:** | **February 28** |
| **Company Address:** | **650 Liberty Avenue**<br>**Union, NJ 07083** |
| **Telephone:** | **908-688-0888** |
| **CEO:** | **Steven H. Temares** |

*Clients of Boyar Asset Management, Inc. own 33,250 shares of Bed Bath & Beyond Inc. common stock at a cost of $64.40 per share.*

*Analysts employed by Boyar's Intrinsic Value Research LLC own shares of Bed Bath & Beyond Inc. common stock.*




## Overview

Bed Bath & Beyond Inc. ("BBBY" or "the Company") is a major operator within the retail sector. BBBY operates roughly 1,500 stores and employs approximately 57,000 people throughout North America, and the firm generates annual revenue of over $10 billion. The stores are primarily located in the U.S., and consist of the following brands: Bed Bath & Beyond, Christmas Tree Shops, Harmon, buybuy BABY, and Cost Plus World Market. BBBY's product line includes a wide range of domestic merchandise and home furnishings. Examples of BBBY's product assortment include bed linens, bath items, kitchen textiles, tabletop items, basic housewares, and general home furnishings and consumables.

A key driver of BBBY's past success has been its coherent and well-executed strategy. BBBY has achieved an impressive record of growth during its operating history, but the rate of expansion has moderated during recent years as the business has gained greater scale. Growth at BBBY has largely been driven by internal investment opportunities that have been periodically supplemented by relatively small M&A transactions.

The intense competition found within the retail industry, and the changes associated with new sales channels (e-commerce, etc.) make a coherent strategy as important as ever. Management utilizes an “everyday low price” philosophy, designed to maintain competitiveness within the marketplace. BBBY considers price competitiveness to be a key means of establishing and maintaining customer relationships. Despite the increased prominence of e-commerce and the perceived savings consumers associate with online shopping, BBBY is actually quite price competitive with what can be found elsewhere. A 2013 study conducted by BB&T Capital Markets found that on a basket consisting of 30 different BBBY products, prices for those products were actually 6.5% lower compared to what was available on Amazon (not including the impact of BBBY coupons). However, pricing is not the only means of differentiation at BBBY. The assortment and presentation of BBBY’s merchandise are unique factors not typically found at its competition among both conventional and online players. Moreover, BBBY’s emphasis on customer service is a key source of differentiation in the in-store experience relative to both e-commerce competitors and other conventional retailers.

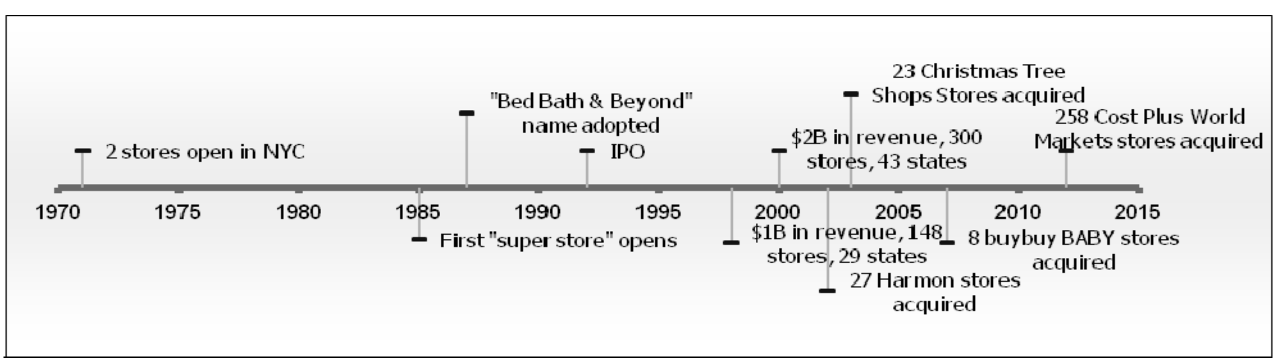
Following a modest shortfall in earnings reported in early January, shares have declined about 15%. The negative sentiment for the stock was exacerbated by a general aversion to retail stocks during early 2014, reflecting broader concerns such as challenging weather conditions and security of customer data. In our view, this recent pullback in BBBY has been unwarranted, and it offers an attractive buying opportunity for long-term investors. Based on our projection for FY 2015, the stock is currently trading at an EV/EBITDA multiple of less than 6.0x, a modest multiple relative to BBBY’s historical trading range. Over the past decade, the stock has typically traded within a range of 6.0x-10.0x from an EV/EBITDA perspective. Assuming BBBY shares can eventually trade at 8.5x EV/EBITDA, and our FY 2015 projections are attainable, the stock’s intrinsic value should be at least $100 per share within the next 2-3 years. This estimate implies appreciation potential of 47% relative to the stock’s current price.

Although near-term performance could remain choppy, we believe the stock’s attractive valuation, combined with BBBY’s solid balance sheet (over $3 per share in net cash) and ongoing share repurchase program (expected to repurchase $1.7 billion of stock by the end of FY 2015) should provide support for the shares. The near-term concerns related to recent earnings results and the overall industry environment have become overstated from our perspective, causing investors to not fully appreciate BBBY’s strong fundamentals and outlook. The firm’s strong financial footing and competitive position could attract the interest of private equity investors at some stage. We would also highlight the relatively advanced ages of BBBY’s founders and co-chairmen (ages 83 and 77 respectively) as another consideration which could make such a scenario possible during the coming years. According to a 2013 report by Harris Williams & Company, the median EV/EBITDA multiple (LTM) paid for retail and consumer companies since 2006 has been 10.0x. Applying such a multiple to our projections for BBBY would suggest a transaction value of approximately $115.

## Background & Business Description

Bed Bath & Beyond began as a 2 store operation selling bed linens and bath accessories in the New York City area in 1971. Since that time co-founders Leonard Feinstein and Warren Eisenberg have pursued a disciplined and measured growth strategy, in terms of concepts, store count, and product offerings. The result is a diversified retail operation that generated almost $11 billion in sales in FY 2012. Importantly the Company’s growth trajectory has remained robust despite its increasing size, with revenue CAGR of 11.6% between FY 2010 and FY 2012.

**The Bed Bath & Beyond Timeline**



Successful growth has been facilitated by a management philosophy that is largely “hands off” at the local level, with on-site inventory management, and a high level of autonomy for store managers to adjust product offerings to meet localized needs. An added benefit of this autonomy is a labor turnover rate among employees that is lower than average for the industry. Despite this autonomy, two constants have been a focus on customer service and a broad product offering. Bed Bath & Beyond has an “everyday low price” philosophy, and was a retail pioneer in terms of the “superstore” concept. The demographic profile of BBBY customers tend to be female, 35-50 years old, with a middle to upper-middle class income level.

This business model has allowed Bed Bath & Beyond to grow from its original concept and 2 stores into 5 concepts and ~1,500 leased stores employing ~57,000 people. The 5 concepts are Bed Bath & Beyond, Christmas Tree Shops, Harmon, buybuy Baby, and Cost Plus World Market. None of the four additional concepts is home grown. Rather, they have been wisely acquired early in their development, and then allowed to organically grow under the Bed Bath & Beyond umbrella. The Company actively seeks to integrate merchandise assortments among its concepts, allowing the smaller concepts to benefit from the economies of scale at the parent level. Additionally, the Company relies on simple modular fixtures for the design of its stores and presentation of its offerings. This allows store layouts to be effortlessly reconfigured as demand for assorted products fluctuates both seasonally and cyclically. The Company purchases merchandise from approximately 7,800 suppliers with no long term contracts in place, and the largest supplier accounts for only 5% of purchases. In addition to its core retail operations, BBBY acquired Linen Holdings, LLC for $105M in June of 2012. Linen Holdings is a distributor of a variety of textile products to institutional customers in the hospitality, cruise, food service and healthcare industries.

Bed Bath & Beyond stores encompass approximately 42.5 million square feet, with the typical store ranging from 20,000-70,000 square feet. Additionally the Company is a partner in a Mexican JV that operates four retail stores under the Bed Bath & Beyond name. The Company’s 5 concepts allow Bed Bath & Beyond to offer a variety of products including bed linens, bath items, kitchen textiles, basic house wares, general home furnishings, and consumables.

- **Bed Bath & Beyond (1,011 stores):** The flagship brand is a dominant presence in houseware goods across such verticals as bed linens, bath accessories, kitchen related products, and small appliances. The Company has also expanded their offerings of food and drinks in recent years. While Bed Bath & Beyond has a national presence, they are predominately an East Coast brand.
- **Cost Plus World Market (269 stores):** Acquired in June of 2012, Cost Plus focuses on home decorating, furniture, and specialty food and beverage. The segment operates stores under the names World Market, Cost Plus World Market, Cost Plus Imports, and World Market Stores. Cost Plus is headquartered in Oakland, California and is primarily a West Coast brand, although they operate in 30 states.
- **Christmas Tree Shops (76 stores):** In the 11 years since acquiring Christmas Tree Shops for $200 million BBBY has more than tripled store count from 23 to 76 as the concept has expanded from its New England roots across the East Coast. In addition to seasonal decorations these stores offer traditional home furnishings.
- **buybuy BABY (86 stores):** BBBY has grown buybuy BABY from 8 stores in 4 East Coast states to 86 stores in 28 states in the 7 years since they acquired the brand. These stores are one stop shops for new parents, offering everything from nursery toys to car seats.
- **Harmon (49 stores):** Harmon is a New Jersey based discount provider of health and beauty products with the majority of their stores located in the NJ, NY, CT Tri-State area. This concept represents BBBY’s first foray with acquisitions. In the twelve years since the purchase store count has grown from 27 to 49, but the geographic footprint has largely remained localized.

## Management

Management at BBBY is a model of consistency, with the least tenured executive officer being CFO Susan Lattman, a relative newcomer with only 18 years of service to the Company. Of note, Lattman replaced Eugene Castagna as CFO, who was promoted to COO, on February 26, 2014. Co-founders Warren Eisenberg (83) and Leonard Feinstein (77) remain actively involved with their Company despite their advancing ages, providing a continuity and quality to capital allocation and overall culture that is common among “owner/operator” companies. The two remain under contract until February 25, 2017. There are no other members of the founding families involved with senior management or the Board, and it is Company policy that the Chairman and CEO positions be held by separate individuals. In addition, as a matter of Company policy, relatives from the founding families typically do not advance beyond the Vice President level. Insider ownership at BBBY currently stands at about 4%.

| Executive Officers | Age | Background |
|---|---|---|
| Warren Eisenberg, Co-Chairman | 83 | Co-Founder, Co-CEO of BBBY 1971-2003 |
| Leonard Feinstein, Co-Chairman | 77 | Co-Founder, Co-CEO of BBBY 1971-2003 |
| Steven Temares, Chief Executive Officer | 55 | Appointed CEO in 2003, joined firm in 1992 |
| Eugene Castagna, Chief Operating Officer | 48 | Appointed COO in '14, CFO in '06, joined firm in '94 |
| Arthur Stark, President & Chief Merchandising Officer | 59 | Appointed CMO in 1999, joined firm in 1977 |
| Matthew Fiorilli, Senior Vice President-Stores | 57 | Appointed SVP-Stores in 1999, joined firm in 1973 |
| Susan Lattmann Chief Financial Officer | 46 | Appointed CFO in 2014, joined firm in 1996 |

## Recent Developments

### *BBBY 3Q Earnings Report Disappoints*

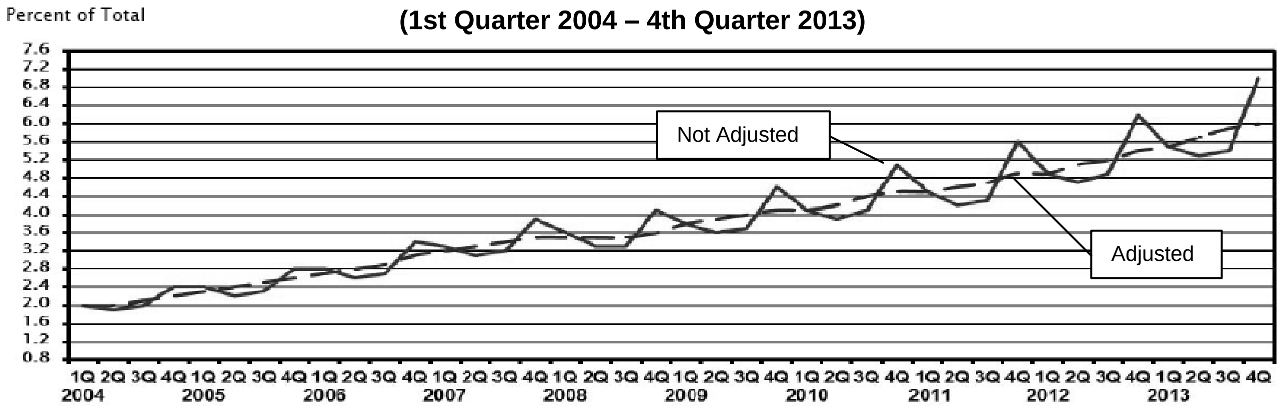
One of the main catalysts for the stock's recent correction relates to a weaker than expected fiscal 3Q earnings report released in January 2014. BBBY reported fiscal 3Q-2013 EPS of $1.12, a 9% year over year increase but $0.03 below investor expectations. Revenue was also modestly disappointing relative to projections, up 6% from 3Q-2012. Same store sales advanced 1.3%, representing a deceleration relative to levels achieved during recent quarters. BBBY modestly increased store count (10 new store locations), illustrated by a 1.4% year over year increase in overall Company square footage. Management cited several issues that contributed to a challenging fundamental backdrop, providing headwinds for margins (both gross and operating margins contracted modestly from a year over year perspective). Among the primary challenges were higher inventory acquisitions costs, increased coupon utilization, and a less favorable sales mix. Importantly, the firm continues to generate a steady stream of cash flow, helping BBBY to maintain a strong balance sheet and return capital to shareholders. BBBY repurchased $171 million of its shares during 3Q-2013 (average price $74 per share), and the Company's overall shares outstanding were down 6% relative to the same period in fiscal 2012. BBBY ended the quarter with net cash and investments of $781 million (over $3 per share). Following the earnings report, BBBY shares dropped by about 12%.

The negative investor reaction also reflected a reduction in future guidance provided by management in conjunction with the earnings report. Looking ahead, BBBY expects fiscal 4Q EPS to be in the range of $1.60 to $1.67 (about a 6% downward revision), implying full-year EPS guidance of $4.79 to $4.86. 4Q comparable same store sales are now expected to increase 2%-4% (down from a previous expectation of 3.5%-5.5%). Going forward, there may also be a temporary uptick in some expenses such as SG&A as the firm continues to spend on initiatives pertaining to its e-commerce capabilities and overall IT infrastructure. Shares of BBBY continued to slide following the earnings and guidance update (down about 15% since the release). However, we would attribute much of the further sell-off to industry related concerns, which caused the overall retail sector to be out of favor in early 2014. Potential implications pertaining to customer data security concerns (highlighted by the data breach at Target), and adverse winter weather conditions in several regions of the U.S. have likely contributed to the general sell-off among retail stocks during recent months. Although data security (additional investments in technology infrastructure) and weak sales comparisons due to weather may be recurring issues across the industry in the near-term, we do not believe these factors materially alter the fundamental outlook for retailers over the long-term.

## Industry Analysis: Navigating the Effects of E-Commerce

The emergence of the Internet has yielded far-reaching effects across the economy, significantly impacting consumer behavior and the overall industry landscape for retailers. The Internet has empowered consumers with an enhanced shopping experience, characterized by improved product research, greater price transparency, and enhanced convenience. Not surprisingly, these benefits have helped fuel the emergence of e-commerce during the past 1-2 decades across the U.S. economy. According to the U.S. Census Bureau, total e-commerce sales in 2013 were over $263 billion, and accounted for 7% of total sales during the most recent quarter. In fact, annual growth in e-commerce has largely remained in a low-mid teens range (excluding the recent recessionary period), and e-commerce has gained an increasingly important role within the overall economy (see chart). The implications are potentially profound within the retail industry, and these considerations will likely gain even greater prominence during the coming years. Findings from a recent report by Forrester Research suggest that by 2017, 60% of all U.S. retail sales will involve the Internet to some degree (research, transactions, etc.). The same report projects that online purchases will represent over 10% of total retail sales within the next five years (almost double 2012 levels). E-commerce utilization also exhibits some seasonality as it tends to represent a higher percentage of overall transactions during the crucial 4Q holiday season.

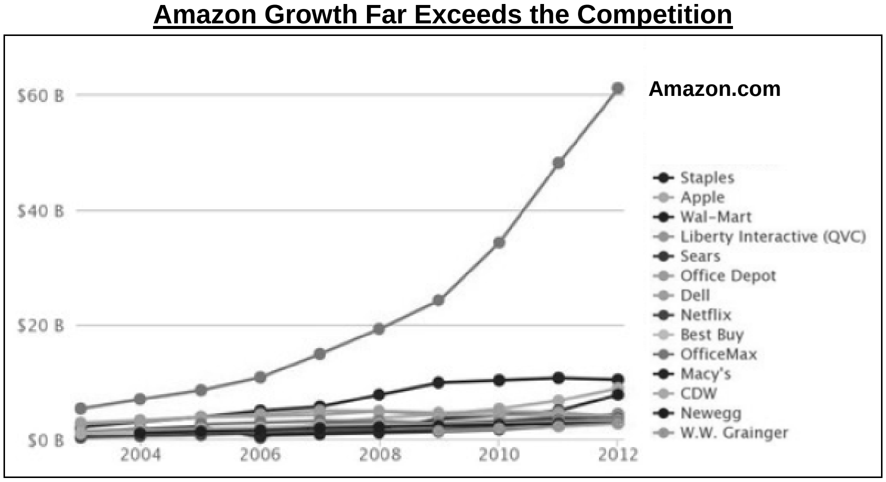
**Estimated Quarterly U.S. Retail E-commerce Sales as a Percent of Total Quarterly Retail Sales**
**(1st Quarter 2004 – 4th Quarter 2013)**




Source: U.S. Census Bureau News, February 2013

The emergence of e-commerce has also impacted the overall competitive landscape within retail. Many e-commerce providers have gained significant prominence within the retailing marketplace, and conventional “bricks and mortar” players have been forced to make adjustments to this new reality, investing substantial sums into information technology to support their own e-commerce capabilities. The most obvious success story that has emerged in this new marketplace has been Amazon (AMZN). The firm has established a dominant presence within e-commerce across many segments within the retail space. AMZN has built a track record of substantial growth that has exceeded many of its peers, supported by internal investment and M&A. Amazon’s sales now exceed $70 billion and its current market capitalization stands at over $160 billion. As the following chart depicts, AMZN has achieved a superior growth trajectory within the e-commerce space. AMZN now has more online sales than its top 12 competitors combined. AMZN’s emergence reflects the new industry reality that conventional retailers now face. In our view, this evolving marketplace presents both a challenge and opportunity for retailers. Moreover, we believe it would be erroneous to assume that all conventional retailers are incapable of successfully adapting to this new environment.

**Amazon Growth Far Exceeds the Competition**




Source: Internet Retailer, *The Wall Street Journal,* wsj.com

However, investors should not disregard the strategic importance of e-commerce and its impact on the competitive landscape within retail. This growing sales channel empowers consumers to make more informed purchase decisions, evaluating retailer product lines based on considerations such as product quality, customer service, and price. One of the most obvious effects of this new environment is the customer behavior known as “showrooming.” According to the Oxford dictionary, showrooming is “the practice of visiting a store or stores in order to examine a product before buying it online at a lower price.” This type of shopping strategy has become more prevalent during recent years as e-commerce players have become more prominent within the industry, and it has been further fueled by the increased utilization of mobile devices such as web-enabled smartphones. A Pew Internet Study conducted in 2013 found that 56% of U.S adults now possess a smartphone (an increasingly important consumer tool, used for in-store research, comparison shopping, etc.). Product categories such as apparel, home improvement and consumer electronics are considered to be among the most influenced by internet-driven research. Based on a study by eMarketer, the number of mobile shoppers in the U.S is projected to increase from 95 million in 2012 to 175 million in 2016. Not surprisingly, this type of behavior is more common among younger consumers. A 2013 survey conducted by Vibes (a firm that specializes in mobile marketing) indicated that 50% of consumers under the age of 35 showroom at least half of the time, while consumers over 35 have a showrooming rate of 31%. Importantly, showrooming is equally prevalent across the full spectrum of income levels. Yet, it warrants mention that an increasing movement toward taxation of Internet-based transactions may cause such price discrepancies between e-commerce providers and conventional retailers to be less pronounced going forward.

The showrooming trend has served to reinforce the importance of price competitiveness for retailers across the industry. However, price alone is not the sole driver of a purchase decision. Rather, retailers can differentiate themselves in the marketplace through other considerations such as product offerings, customer service, and increasingly personalized marketing strategies. Conventional retailers can distinguish product lines by its diversity, and by offering products or brands that are exclusively available within their respective stores. Customer service (depending on the product category) is often a key aspect of the in-store experience, and is difficult to replicate via mobile or online channels in our view. Personalized marketing messages (often delivered by email or mobile message) can be used to segment and target customers based on consumer data and transaction history, creating a more relevant marketing message that is more likely to result in a sale. Yet, we believe the more important take-away is that conventional retailers must be positioned to compete across all possible sales channels (in-store, online, mobile). This “omni-channel” retailing approach will likely be increasingly crucial to long-term success within the industry, as retailers utilize all possible venues (using an integrated approach) to meet consumer needs and ultimately drive transactions. An omni-channel strategy requires significant capabilities that involve meaningful investment in areas such as technology, distribution, and order fulfillment. Retailers that can build and maintain such capabilities will be best positioned to gain market share over the long-term. Moreover, such capabilities could represent a barrier to entry to new competitors within the retail sector during the coming years. A 2013 report by Jones Lang LaSalle on the subject of e-commerce helped to summarize the requirements for executing the omni-channel strategy:

> *“The key to omni-channel is the integration of processes, information systems and infrastructure, including property, to enable the retailer to meet customer demand from whatever location is positioned to provide the best customer experience.”*
>
> *– Jones Lang LaSalle report, November 2013*

**Bed Bath & Beyond: Future Strategy**

A key driver of BBBY’s past success has been its coherent and well-executed strategy. The intense competition found within the retail industry, and the changes associated with new sales channels make this issue as important as ever. As mentioned earlier in this report, management utilizes an “everyday low price” philosophy, designed to maintain competitiveness within the marketplace. BBBY considers price competitiveness to be a key means of establishing and maintaining customer relationships. The firm also sometimes relies on promotions and coupons to help stimulate sales and traffic. Despite the increased prominence of e-commerce and the perceived savings consumers associate with online shopping, BBBY is actually quite price competitive. A 2013 study conducted by BB&T Capital Markets found that on a basket consisting of 30 different BBBY products, prices for those products were actually 6.5% lower compared to what was available on Amazon (not including the impact of BBBY coupons).

However, pricing is not the only means of differentiation at BBBY. The assortment and presentation of BBBY's merchandise are unique factors not typically found at its competitors among both conventional and online players. BBBY's diverse product line is apparent when entering one of its store locations. Products consist of both well-recognized outside brands and the Company's own proprietary brands. Although proprietary products likely represent a relatively modest portion of overall sales (not quantified by the Company), this could be an area of emphasis going forward as a means of further differentiating the product line. The wide breadth of products allows BBBY to gain a greater share of customer purchases, while serving to reinforce the Company's strong brand identity. BBBY is continuously testing new products and merchandise categories in order to adapt to changing consumer tastes, and can adjust the assortment and mix of merchandise to reflect a store's local market conditions. Store layouts are organized by product categories (kitchen section, bedroom section, etc.) in order to create the appearance of several individual specialty stores within one site. The generous dimensions of most stores (typically 20,000-70,000 feet) allow most inventory to be kept at the store site, helping to further demonstrate the breadth and diversity of BBBY's product line. BBBY relies on a diverse network of largely domestic suppliers, and most supplier contracts are short term in nature.

In our view, BBBY's emphasis on customer service is a key source of differentiation relative to both e-commerce competitors and other conventional retailers. The knowledge and service of the store personnel is a key aspect of the BBBY shopping experience, and is supported by employee training and a "promote from within" approach that incentivizes employee performance and translates to below average employee turnover. Importantly, each individual store manager is afforded relatively high flexibility to manage product mix to adapt to local customer preferences. To create maximum shopping convenience, store layouts are clearly organized so that customer can easily access the desired products and expertise. Most BBBY store locations are open 7 days a week. Products can also be purchased 24 hours a day via the e-commerce channels. Each store concept has its own individual web site which offers assistance with product purchases, product returns, and other information. BBBY has focused on significantly enhancing its ecommerce presence and capabilities during recent years via investment in information technology and related infrastructure. To support inventory management and order fulfillment, BBBY utilizes 15 distribution facilities (about 6 million square feet).

The Company's reputation for merchandise and customer service allow it to largely rely on "word of mouth" advertising as existing customers help to communicate the firm's value proposition within the marketplace. As a result, BBBY does not invest significant resources in advertising, although it does opportunistically utilize promotional methods such as circulars and direct mail to raise customer awareness and stimulate traffic in the stores. Ultimately, couponing and other promotional tools are designed to acquire new customer relationships that will extend beyond promotionally priced items. The Company also utilizes digital channels for advertising and product promotion (email, mobile, Internet search advertising, etc.) During the last 3 fiscal years, annual net advertising costs have averaged about $214 million, translating to about 2% of sales (this figure can be closer to 4% for firms such as Pier 1 Imports).

## **Bed Bath & Beyond: Growth Opportunities**

BBBY has achieved an impressive record of growth during its operating history, but the rate of expansion has moderated during recent years as the business has gained greater scale. Growth at BBBY has largely been driven by internal investment opportunities that have been periodically supplemented by relatively small M&A transactions. It is important to mention that growth opportunities have historically been pursued in a financially responsible manner which has allowed the firm to also maintain strong returns throughout its history, with little or no debt (see following table for a 10-year history). Looking ahead, we believe there are ample organic opportunities for growth at BBBY during the coming years. However, such growth will likely be pursued in a measured way, consistent with BBBY's track record and management's general philosophy concerning creating long-term shareholder value. Additionally, improvements in general fundamentals for the U.S. economy and U.S. residential real estate could provide additional tailwinds for growth in sales and profits during the coming years. Utilizing relatively conservative assumptions, we believe sales of $12.6 billion and EBITDA of $2.1 billion could be attainable by FY 2015.

**A Record of Profitable Growth**

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | AVG |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Sales Growth** | 22.2% | 15.0% | 12.9% | 13.9% | 6.5% | 2.3% | 8.6% | 11.9% | 8.5% | 14.9% | **11.7%** |
| **Operating Margin** | 14.3% | 15.4% | 15.1% | 13.4% | 11.9% | 9.3% | 12.5% | 14.7% | 16.5% | 15.0% | **13.8%** |
| **ROE** | 23.2% | 24.1% | 25.7% | 24.2% | 21.6% | 15.3% | 18.0% | 20.9% | 25.2% | 25.9% | **22.4%** |
| **Debt** | Nil | Nil | Nil | Nil | Nil | Nil | Nil | Nil | Nil | Nil | **Nil** |

The Company's largest store concept (Bed Bath & Beyond) continues to be the primary driver of sales and profits, with over 1,000 store locations (roughly two-thirds of the total Company store base). Management believes that markets in the United States and Canada could ultimately support 1,300 stores. Although management has already conducted significant due diligence to identify potential new store locations, no time frame has been provided for reaching the 1,300 store count objective. Given BBBY's current geographic footprint, relatively under-penetrated regions such as the Mountain West and West Coast could represent the best opportunities for store expansion. Given the Company's operating philosophy and recent record of expansion, we would expect year over growth in Bed Bath & Beyond stores to be relatively modest during the coming years (likely in the 1%-3% range).

In our view, the growth potential of BBBY's smaller concepts (Cost Plus World Market, Christmas Tree Shops, buybuy BABY, Harmon) is often overlooked by investors. Collectively, these concepts now represent about one-third of BBBY's total store base, and this figure will likely rise over time. The respective sales contributions of these stores are not currently disclosed by management, but the increases in store locations are difficult to ignore. Just since our last *Asset Analysis Focus* report on BBBY (published September 2012), store counts for these concepts are up 8%, compared to a 2% increase in store count for Bed Bath & Beyond stores during the same period. The biggest growth driver (buybuy Baby) has increased store count by 26% since September-2012. We expect mid-high single digit growth to remain attainable for BBBY's smaller concepts for the foreseeable future given their relatively modest levels of penetration from a national perspective. Additionally, these smaller store concepts help to complement the Bed Bath & Beyond stores, via product line expansions and "store-in-store" layouts. It is conceivable that management may consider acquiring other store brands over time, provided such transactions fit with the existing strategy and culture. In our view, such M&A would likely take the form of smaller bolt-on type transactions, rather than a larger scale or more transformative deal.

Although the rates of growth achieved by BBBY in its earlier years is unlikely to be repeated given the firm's increased scale and market presence, meaningful expansion opportunities still do exist. Importantly, investors are likely overlooking these opportunities as recent earnings disappointments and a general investor aversion to the retail industry have caused undue emphasis on short-term factors. Expansion opportunities for Bed Bath & Beyond stores remain significant, and the Company's smaller concepts such as Harmon and buybuy BABY should provide an increasingly important source of sales growth going forward. Despite industry pressures such as the emergence of e-commerce, we believe BBBY continues to possess a strong competitive position that can support additional gains in sales and profits during the coming years. Looking to FY 2015, we believe sales and EBITDA of $12.6 billion and $2.1 billion should be attainable, representing growth of 8% and 10% relative to expectations for the current fiscal year (FY 2013).

**Balance Sheet and Financial Position**

With no debt, ~$780 million in cash and investments ($3.67/share), and healthy free cash flow, BBBY's financial position is secure. A brief history of the Company's cash balance provides evidence that the Company is able to build cash quickly in a diverse range of environments, and is willing to deploy it aggressively when opportunities arise. On an equivalent quarter basis, at the end of Q3'07, the Company had total cash and securities of $377,358. By Q3'11 this number had jumped more than 330% as the Company turned defensive given the financial crisis. As signs of the recovery began to take hold, the Company turned aggressive and made their largest acquisition to date (Cost Plus World Market for ~$495M). In the last few years the Company has continued to deploy cash as a large acquirer of their own stock (more on this below).

Currently cash and investments are made up of 60% Cash & Equivalent, 29% Short Term Investment Securities, and 11% Long Term Investment Securities. Investment securities are predominantly U.S. Treasury Bills, and they hold ~$51 million in auction rate securities. While the Company is debt free, they do lease substantially all of their existing stores under leases that generally range from 10 to 15 years. Most leases provide for renewal options, some have rent increases built in, and some include contingent rent kickers. As of the most recent 10-K the Company disclosed ~$3.3 billion in operating lease obligations. BBBY would consider taking on debt in order to pursue the right opportunity in the marketplace, but management does not view a financially leveraged balance sheet as a positive driver of long-term value.

Free cash flow has averaged ~$890 million over the last three years, equating to a current yield of more than 6% on a FCF basis. While the Company has not historically paid a dividend, management has proven that they are capable capital allocators, having used their cash to opportunistically and successfully acquire new brands, and having been consistent repurchasers of their own stock. Since their 2004 10-K, buybacks have totaled more than $5.8 billion and shares outstanding have declined more than 29%. The Company has been particularly aggressive in recent years, with shares outstanding down by 17% since 2011, and having returned ~86% of cash flow from operations to shareholders over the last 2 years. The current authorization has approximately $1.7B left, which at current prices equates to about 12% of shares outstanding. Management has indicated that they expect this authorization will be completed by the end of fiscal 2015. BBBY's board of directors is not averse to considering issuing dividends to shareholders in the future, but has historically preferred share repurchase as a flexible means of opportunistically returning capital to investors.

We view BBBY's strong financial position and robust cash flow generation as competitive advantages in a segment with relatively low barriers to entry. The Company's strong financial position provides management with optionality to help stave off the impact of cyclical as well as secular threats. We believe this to be particularly important in a world where online competition remains stiff and attempts to compete on price with bricks & mortar retailers. Opportunistic M&A remains a possibility as well, particularly in the current challenging retail environment which likely has many smaller brands struggling to maintain their nascent position, let alone finance growth. We suspect that BBBY's culture of decentralized management and history of successfully developing acquired brands would make them a preferred buyer for independent retail operators that would tuck in nicely.

Management has guided CapEx for fiscal 2013 to be $340M, which we believe is likely above "normal." This elevated level is tied to several major initiatives which have been undertaken in 2013, including overhauling www.buybuybaby.com and www.bedbathandbeyond.com, upgrading mobile sites and apps, building a new IT Data Center, and investing in in-store POS improvements. This increased spend should contribute to the Company's success over time and will likely drop off as these improvements are completed. That being said, current plans call for opening 30 new stores across all concepts in fiscal 2014 versus 10 new stores in fiscal 2013. This increased pace will of course result in higher CapEx, but we note that this is clearly growth CapEx and could be easily adjusted downward if necessary. We believe a more "normal" CapEx level to be closer to $300M.

## Valuation & Conclusion

From a historical point of view, BBBY shares have been a very sound investment. The stock has roughly doubled over the past decade, and appreciation has been even more pronounced from a longer-term perspective. Clearly, the firm's well established record of profitable growth has been a key driver of shareholder value, further supported by consistent returns of capital to shareholders via stock buybacks. Although BBBY's growth trajectory has entered into a more moderate phase, we believe the Company continues to have an attractive set of opportunities to grow profits over the coming years and further enhance long-term shareholder value. BBBY shares were also solid performers during 2013 (up over 40%), but more recent performance has been less robust. Following a modest shortfall in earnings reported in early January, shares have declined about 15%. The negative sentiment for the stock was exacerbated by a general aversion to retail stocks during early 2014, reflecting broader concerns such as challenging weather conditions and security of customer data. In our view, this recent pullback in BBBY has been unwarranted, and it offers an attractive buying opportunity for long-term investors.

| Company Name | Ticker | TTM P/E | TTM EV/EBITDA | TTM Operating Margin | TTM ROE |
|---|---|---|---|---|---|
| Home Depot | HD | 21.8x | 11.5x | 11.6% | 35.6% |
| Lowe's Companies | LOW | 23.3x | 10.9x | 7.8% | 17.8% |
| Pier 1 Imports | PIR | 15.7x | 7.5x | 11.4% | 25.8% |
| Williams Sonoma | WSM | 22.0x | 9.9x | 10.6% | 23.3% |
| ***Average*** | | ***20.7x*** | ***9.9x*** | ***10.4%*** | ***25.6%*** |
| ***Bed Bath & Beyond*** | ***BBBY*** | ***13.8x*** | ***7.0 x*** | ***14.4%*** | ***26.2%*** |

Based on our projections for FY 2015, the stock is current trading at an EV/EBITDA multiple of less than 6.0x, a modest multiple relative to BBBY's historical trading range. BBBY's current valuation is also modest relative to similar publicly traded companies (BBBY trading at about a 30% discount to peers), despite possessing a superior level of profitability (see table above). Over the past decade, the stock has typically traded within a range of 6.0x-10.0x from an EV/EBITDA perspective. Assuming BBBY shares can eventually trade at 8.5x EV/EBITDA, and our FY 2015 projections are attainable, the stock's intrinsic value could be at least $100 per share within the next 2-3 years. This estimate of intrinsic value implies appreciation potential of 47% relative to the stock's current price (see following table). Although near-term performance could remain choppy, we believe the stock's attractive valuation, combined with BBBY's solid balance sheet (over $3 per share in net cash) and ongoing share repurchase program (expected to repurchase $1.7 billion of stock by the end of FY 2015) should provide support for the shares.

**BBBY Estimate of Intrinsic Value**

| FY 2015 | Value ($MM) |
|---|---|
| BBBY @ 8.5x EV/EBITDA | $18,002 |
| Net Cash & Investments (3Q FY13) | 781 |
| Equity Value | $18,783 |
| Shares Outstanding (FY 2015) | 188 |
| Intrinsic Value Estimate Per Share | **$99.91** |
| Upside from Current Price | 47% |

In our view, our estimate of BBBY's intrinsic value could prove to be conservative from a long-term perspective. Assuming a favorable economic backdrop, sales and EBITDA could potentially exceed our projections. Moreover, the firm's strong financial footing and competitive position could attract the interest of private equity investors at some stage. We would also highlight the relatively advanced ages of BBBY's founders and co-chairmen (ages 83 and 77) as another consideration which could make such a scenario possible during the coming years (Warren Eisenberg and Leonard Feinstein currently own about 3% of BBBY shares). According to a 2013 report by Harris Williams & Company, the median EV/EBITDA multiple (LTM) paid for retail and consumer companies since 2006 has been 10.0x. Applying such a multiple to our FY 2015 projections for BBBY would suggest a transaction value of approximately $115.

Overall, we view BBBY as a well managed retailer that is poised to create long-term value for its shareholders. The Company's strong financial footing and competitive position, combined with consistent return of capital to shareholders should translate to both growth and multiple expansion during the coming years. Our estimate of intrinsic value suggests potential upside of 47% from the current price, and this could prove to be conservative from a long-term perspective. The near-term concerns related to recent earnings results and the overall industry environment have become overstated in our view, causing investors to overlook BBBY's strong fundamentals and outlook.

## Risks

The Company's primary risks include:

- BBBY's strong balance sheet and cash flow generation could allow management to pursue M&A opportunities that are financially or strategically unattractive.
- A general downturn in fundamentals for consumer activity or general economic conditions could cause BBBY's future trends in sales and profitability to come under pressure.
- The further emergence of e-commerce competitors, and failure to address e-commerce issues could jeopardize BBBY's long-term profitability and competitive position within the industry.
- A reduced role of BBBY's co-founders could cause unfavorable changes in management style and Company culture over the long-term.
- The Company's strong growth record and increased industry prominence could make future growth rates more modest relative to past years.

## Analyst Certification

Asset Analysis Focus certifies that the views expressed in this report accurately reflect the personal views of our analysts about the subject securities and issuers mentioned. We also certify that no part of our analysts' compensation was, is, or will be, directly or indirectly, related to the specific views expressed in this report.

## BED BATH & BEYOND INC.

**CONSOLIDATED BALANCE SHEETS**
**(in thousands)**
**(unaudited)**

| **ASSETS** | **Nov. 30, 2013** | **March 2, 2013** |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 471,064 | $ 564,971 |
| Short term investment securities | 223,114 | 449,933 |
| Merchandise inventories | 2,881,561 | 2,466,214 |
| Other current assets | 478,865 | 386,367 |
| *Total current assets* | 4,054,604 | 3,867,485 |
| Long term investment securities | 87,021 | 77,325 |
| Property and equipment, net | 1,523,253 | 1,466,667 |
| Goodwill | 486,279 | 483,518 |
| Other assets | 393,332 | 384,957 |
| **TOTAL ASSETS** | **$ 6,544,489** | **$ 6,279,952** |

| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
|---|---|---|
| Current liabilities: | | |
| Accounts payable | $ 1,145,281 | $ 913,365 |
| Accrued expenses and other current liabilities | 417,073 | 393,094 |
| Merchandise credit and gift card liabilities | 267,332 | 251,481 |
| Current income taxes payable | 3,674 | 77,270 |
| *Total current liabilities* | 1,833,360 | 1,635,210 |
| Deferred rent and other liabilities | 493,845 | 484,868 |
| Income taxes payable | 87,456 | 80,144 |
| TOTAL LIABILITIES | 2,414,661 | 2,200,222 |
| Shareholders' equity: | | |
| Preferred stock - $0.01 par value | – | – |
| Common stock - $0.01 par value | 3,349 | 3,327 |
| Additional paid-in capital | 1,658,082 | 1,540,451 |
| Retained earnings | 8,262,603 | 7,573,612 |
| Treasury stock, at cost | (5,785,579) | (5,033,340) |
| Accumulated other comprehensive loss | (8,627) | (4,320) |
| TOTAL SHAREHOLDERS' EQUITY | 4,129,828 | 4,079,730 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | **$ 6,544,489** | **$ 6,279,952** |

Disclaimers

Asset Analysis Focus is not an investment advisory bulletin, recommending the purchase or sale of any security. Rather it should be used as a guide in aiding the investment community to better understand the intrinsic worth of a corporation. The service is not intended to replace fundamental research, but should be used in conjunction with it. Additional information is available on request.

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