Best Buy Co. Inc. (BBY)

Updated February 19th, 2019 by Prakash Kolli

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	6.9%	**Volatility Percentile:**	82.8%
Fair Value Price:	$49	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	19.4%
% Fair Value:	123%	**5 Year Valuation Multiple Estimate:**	-4.1%	**Growth Percentile:**	75.0%
Dividend Yield:	3.0%	**5 Year Price Target**	$72	**Valuation Percentile:**	20.0%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	32.5%

Overview & Current Events

Best Buy Co. Inc. is the largest consumer electronics retailer in North America with operations in the U.S., Canada and Mexico. The company's annual sales exceed $40B. Best Buy sells consumer electronics, personal computers, software, mobile devices, and appliances and provides services. At end of FY 2018, Best Buy operated 1008 stores of its flagship brand in the U.S, 134 stores in Canada and 25 stores in Mexico. The company operates several store-within-store partnerships with Amazon, Google, Sony, Samsung and Microsoft. Best Buy trades with a market capitalization of $16B.

Best Buy reported 3Q2019 earnings on November 20, 2018. The company's sales growth momentum under current management has continued. The company reported 4.3% U.S. (domestic) sales growth, 12.6% U.S. online sales growth and 3.7% international sales growth, all on a year-over-year basis. This was the seventh straight quarter of organic sales growth. Best Buy reported a 27% increase in GAAP diluted EPS to $0.99. The company typically provides guidance in non-GAAP numbers and from that perspective, increased FY2019 estimates to $5.09 to $5.19 from $4.95 to $5.10. This quarter's results also benefitted from a tax rate of 16.1% versus 30.4% last year due to the U.S. Tax Cut and Jobs Act.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.39	$3.10	$3.08	-$3.36	-$0.16	$2.00	$3.53	$2.30	$3.74	$3.26	***$3.50***	***$5.14***
DPS	$0.56	$0.58	$0.62	$0.66	$0.68	$0.72	$0.92	$1.12	$1.36	$1.80	***$1.91***	***$2.55***
Shares	423	428	417	375	339	348	354	351	323	307	***298***	***256***

Note that we report diluted GAAP EPS in the above chart. Best Buy typically highlights non-GAAP EPS due to annual non-recurring restructuring charges. The company also changed its reporting date in FY2013 reporting only an 11-month FY2013. In 1Q2018 the company stopped excluding non-restructuring property and equipment impairment charge and recast non-GAAP EPS back to 2013.

Best Buy's diluted EPS growth is volatile. It was affected by the recession and more recently the ongoing transition to online shopping in the U.S. In fact, sales growth was negative and flattish from 2012 to 2017. Much of the gain in EPS was due to reduction in share count that has dropped dramatically over the past decade. But saying that, the company had solid top line growth and operating income increases in 2018 that look to extend into 2019. The company's efforts to prioritize online sales growth, store count and extract cost efficiencies seem to be taking hold. We are forecasting 8% EPS growth out to 2024. The dividend has increased at a double-digit rate over the past four years and we anticipate that to slow to 6% as the payout ratio based on diluted EPS is near 55%.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/E	16.5	11.1	7.6	NMF	NMF	19.5	8.6	18.6	18.3	16.2	***17.2***	***14.0***
Yld.	1.4%	1.7%	2.7%	5.6%	1.7%	1.8%	3.0%	2.6%	2.0%	3.4%	***3.0%***	***2.6%***

Best Buy's P/E multiple history has been nearly as volatile as its earnings history. We believe that a fair valuation number for Best Buy is a P/E of 14.0. This is slightly higher than its 10-year average but we account for Best Buy's improvement in organic sales growth, traction in online sales and cost efficiency efforts. Notably the P/E ratio is elevated relative to the long-term average. If the company returns to a P/E ratio of 14.0 this will result in headwinds of -4.1% annually from valuation. We anticipate that the dividend yield will be roughly 2.6% in 2024. We initiate coverage of Best Buy with 5-year price target of $72 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	23.4%	18.7%	20.1%	NMF	NMF	36.0%	26.1%	48.7%	36.4%	55.2%	***54.5%***	***50%***

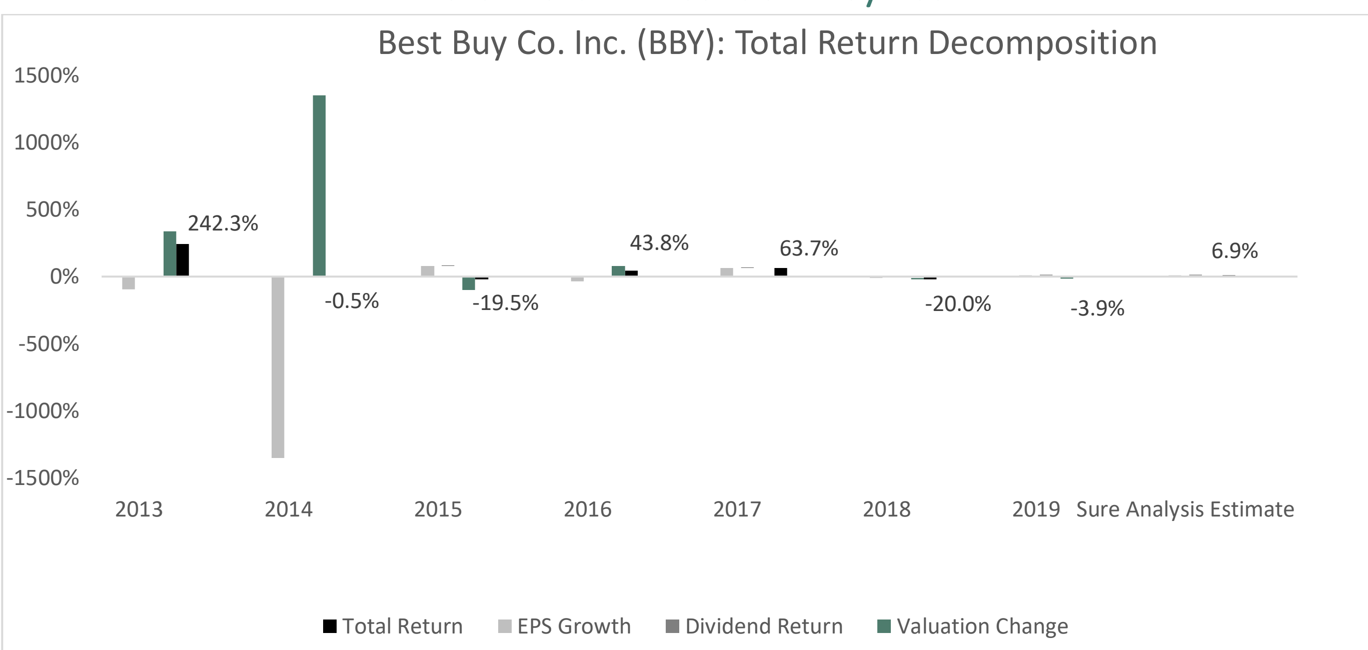
As a retailer Best Buy is in a very competitive industry. Although it is the largest electronics retailer, the company has for the most part no significant advantage. Both Walmart and Costco sell electronics and have scale and cost advantages. Best Buy is also not the clear market leader for online electronics retailing as Amazon, Walmart, Apple and others provide significant competition there. However, Best Buy's Geek Squad does provide an advantage relative to other traditional retailers as they provide a level of expertise and service not typically found at other retailers.

Best Buy makes conservative use of debt with only $1,280M of long-term debt that is offset with $1,304 in cash and short-term investments, giving it a net cash position. The dividend is currently covered but the payout ratio is much higher than during the last recession. A significant downturn in sales and EPS during a slowdown could lead to a cut.

Final Thoughts & Recommendation

At present we are forecasting 6.9% annualized returns over the next five years comprising mostly of 8.0% EPS growth, 3.0% dividend and -4.1% from P/E multiple contraction. The company's P/E ratio is noticeably higher than its long-term average and can be volatile. Although Best Buy performed solidly in 2018 and this looks to extend into the next few years, the company's earnings can also be volatile. Saying that, we do not recommend this stock for those seeking conservative dividend growth or safe income at current prices.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	45015	49243	49747	45457	38252	40611	40339	39528	39403	42151
Gross Profit	10998	12042	12541	10984	9023	9399	9047	9191	9440	9876
Gross Margin	24.4%	24.5%	25.2%	24.2%	23.6%	23.1%	22.4%	23.3%	24.0%	23.4%
SG&A Exp.	8984	9622	10029	8755	7905	8106	7592	7618	7547	8023
D&A Exp.	793	926	978	945	832	716	656	657	654	683
Operating Profit	2014	2420	2512	2229	1118	1293	1455	1573	1893	1853
Op. Margin	4.5%	4.9%	5.0%	4.9%	2.9%	3.2%	3.6%	4.0%	4.8%	4.4%
Net Profit	1003	1317	1277	-1231	-441	532	1233	897	1228	1000
Net Margin	2.2%	2.7%	2.6%	-2.7%	-1.2%	1.3%	3.1%	2.3%	3.1%	2.4%
Free Cash Flow	574	1591	446	2527	749	547	1374	694	1977	1453
Income Tax	674	835	779	742	263	388	141	503	609	818

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	15826	18302	17849	16005	16787	14013	15245	13519	13856	13049
Cash & Equivalents	498	1826	1103	1199	1826	2678	2432	1976	2240	1101
Acc. Receivable	N/A	N/A	N/A	2288	2704	1308	1280	1162	1347	1049
Inventories	4753	5486	5897	5731	6571	5376	5174	5051	4864	5209
Goodwill & Int.	2698	2890	2790	1694	862	526	482	443	443	443
Total Liabilities	10670	11338	10557	11639	13072	10024	10245	9141	9147	9437
Accounts Payable	4997	5276	4894	5364	6951	5122	5030	4450	4984	4873
Long-Term Debt	1963	1802	1709	2208	2296	1657	1613	1734	1365	1355
Total Equity	4643	6320	6602	3745	3061	3986	4995	4378	4709	3612
D/E Ratio	0.42	0.29	0.26	0.59	0.75	0.42	0.32	0.40	0.29	0.38

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.0%	7.7%	7.1%	-7.3%	-2.7%	3.5%	8.4%	6.2%	9.0%	7.4%
Return on Equity	22.0%	24.0%	19.8%	-23.8%	-13.0%	15.1%	27.5%	19.1%	27.0%	24.0%
ROIC	16.1%	16.6%	14.4%	-15.8%	-7.0%	9.1%	20.1%	14.1%	20.2%	18.1%
Shares Out.	423	428	417	375	339	348	354	351	323	307
Revenue/Share	106.44	115.19	119.44	121.38	112.97	116.83	114.08	112.71	122.14	137.26
FCF/Share	1.36	3.72	1.07	6.75	2.21	1.57	3.89	1.98	6.13	4.73

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.