



January 5, 2012

## Best Buy Gaining 59% as Cash-Rich Retailer Invites LBO: Real M&A

By Tara Lachapelle

For private equity buyers looking for a retailer that throws off the most cash, there's no bigger bargain than Best Buy Co.

After losing almost a third of its market value in 2011, the world's largest seller of consumer electronics is now valued at just 3.6 times its free cash flow, the cheapest of any retailer worth more than \$1 billion, according to data compiled by Bloomberg. Best Buy, one of the five worst-performing retail stocks in the Standard & Poor's 500 Index last year, has also reached its cheapest valuation relative to earnings.

**While same-store sales have fallen in five of the past six quarters as demand for televisions slumped and competition from Amazon.com Inc. and Wal-Mart Stores Inc. intensified, Best Buy can still enrich leveraged buyout firms after generating \$2.44 billion in free cash in the past year, Telsey Advisory Group and Morningstar Inc. said. The \$8.14 billion company could get at least \$37 a share in a takeover, according to Thornburg Investment Management, 59 percent more than its price yesterday.**

**"Now would be the time, if I were private equity, to be dusting this off," Joe Feldman, a New York-based analyst at Telsey, said in a telephone interview. "They generate a ton of free cash. From a valuation standpoint, it does look like an attractive candidate for a takeout."**

Susan Busch, a spokeswoman for Richfield, Minnesota-based Best Buy, declined to comment on the decrease in its value or whether the company has been approached about a sale.

Last year, Best Buy fell 32 percent, more than all but three retailers in the S&P 500, the benchmark gauge of American common equity, according to data compiled by Bloomberg. On average, U.S. retail stocks rose 2.9 percent in 2011.

### Relative Value

With Best Buy ending at \$23.23 yesterday, it now trades at about 3.6 times its cash from operations after deducting capital expenses of \$6.46 a share, the data show. That's less than a quarter of the industry's median of 17.6 times.

The retailer is also valued at 2.8 times earnings before interest, taxes, depreciation and amortization in the past 12 months, the lowest level since at least 1990, according to data compiled by Bloomberg.

"By any valuation approach you want to use, it looks inexpensive," Matt Arnold, an analyst for St. Louis-based Edward Jones & Co., said in a telephone interview.

Best Buy, which sells everything from mobile phones to TVs and dartboards at its more than 4,000 locations, has fallen as shoppers sought bigger discounts on the same items from online merchants such as Amazon in Seattle or at Bentonville, Arkansas-based Wal-Mart, the world's largest retailer.

#### 'Must-Have'

The company has also been hurt by a lack of must-have electronics items, according to Brian Nagel, a New York-based analyst at Oppenheimer & Co. The company's same-store sales decreased for five straight quarters before rebounding 0.3 percent in the three months ended Nov. 26.

"Best Buy has basically contended with a really tough product cycle and increased competition over the last few years," he said in telephone interview. "These online retailers are selling products for a lot cheaper, and that's difficult for Best Buy to contend with. The stock has been so weak because of those factors."

Best Buy's slump may now attract private equity funds because it still produces more free cash than any comparable retailer and has more cash than debt, according to R.J. Hottovy, director of consumer research at Chicago-based Morningstar.

A buyout firm could close more stores, shrink the size of other Best Buy locations and replace management to cut costs and help it compete with merchants such as Amazon, he said. In April, Best Buy said it planned to reduce the square footage in its U.S. "big-box" stores by 10 percent in the next three to five years to lower costs by as much as \$80 million annually.

#### Takeout Price

"With regard to private equity, this is a situation that might make some sense," Hottovy said in a telephone interview. "It does have a solid free cash flow profile and this is a situation where Best Buy may benefit from a more dynamic leadership group, a group that understands the evolving dynamics of the consumer electronics retail business."

One obstacle an LBO firm could face is resistance from Best Buy Chairman Richard Schulze, who founded the company and owns about 20 percent of its stock, according to Bradley Thomas, an analyst with KeyBanc Capital Markets Inc. in New York.

"I would be surprised if he would support the more short-sided and financially-oriented approach that an LBO investor would be looking to generate," he said.

Still, with the additional cost cuts and earnings a private equity firm could potentially wring out, Best Buy may command at least \$37 a share in a buyout, or \$13 billion, according to Di Zhou, a Santa Fe, New Mexico-based analyst at Thornburg, which oversees \$70 billion in assets and owned Best Buy stock at the end of September. Zhou based her estimate on analysts' average earnings projections and a multiple of 10 times.

"Some of the things we see, private equity firms could see as well," she said.