

**Strategic Report for**

**BEST BUY CO., INC.**



Ian Kwok  
Rhett Dornbach-Bender  
Rebecca Lange

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## Executive Summary

Best Buy Co., Inc. is a multinational retailer of technology and entertainment products and services. It has operations in the U.S., Canada, China, Europe and Mexico. Headquartered in Minnesota, Best Buy controls a portfolio of retail stores and websites under 11 brand names. In the U.S., Best Buy is the largest consumer electronics retailer with a market capitalization of \$16.53 billion. For the fiscal year ended February 28, 2009, Best Buy reported \$45 billion in revenues.

Brad Anderson, the CEO of Best Buy Co., Inc., approached Oasis Consulting in September 2008 for strategic assistance to his company's business operations amidst the U.S. credit meltdown. Specifically, Mr. Anderson would like Oasis Consulting to review his domestic business operations and provide strategic recommendations going forward.

Oasis Consulting has identified two main challenges for Best Buy's operations in the U.S. First, Best Buy needs to make sure it is in a favorable position to cope with falling consumer discretionary spending. Second, Best Buy will continue to face stiff competition despite its largest competitor, Circuit City, went out of business at the end of March 2009. The competition will come from discount retailers such as Wal-Mart and Target, as well as internet retailers such as Amazon.com and eBay.

Given the challenges, Oasis Consulting has developed and recommended both short-term and long-term solutions. In the short-term, Oasis Consulting believes that Best Buy must energize its services component of its retail business to support the anticipated decreases in revenue. It believes that consumers, even in times of economic turmoil, will demand (if not more) assistance with their existing products. In the long-term, Oasis Consulting advises Best Buy to rethink its entire retail experience and develop a unique "shopping experience" that integrates and engages the customer with their products. With this innovative model, Best Buy should be able to continue bringing positive returns to its stakeholders.

## Company Overview

Best Buy Co., Inc. (NASDAQ: BBY) together with its subsidiaries is one of the world's leading companies that operates as a retailer of consumer electronics, home office products, entertainment software, appliances and related services in the United States, Canada, China, Europe and Mexico. It controls retail stores and websites under 11 brand names: Best Buy, Five Star Appliances, Future Shop, Geek Squad, Magnolia Audio Video, The Carphone Warehouse, Best Buy Mobile, Audiovisions, Napster, Pacific Sales and Speakeasy. Best Buy currently has about 165,000 employees worldwide.

The company preliminarily recorded revenues of \$45 billion during the fiscal year ended February 28, 2009, a 12.5% increase over 2008. The operating profit during the FY09 was \$1.76 billion, an 18.6% decrease over 2008. The net income during the same period was \$1 billion, a 28.7% decrease from 2008.<sup>1</sup>

### **History**

Best Buy was originally founded as Sound of Music, Inc. by Richard Schulze and another partner in 1969. It operated as a single home and car audio specialty store in St. Paul, Minnesota. In 1971, he bought out his partner and began to expand the chain. By early 1980s, Schulze broadened the product line to include appliances and VCRs to target older and more affluent customers. Schulze would continue to expand the product line to suit the needs of his customers.

After almost 20 years of operations, Sound of Music officially changes its name to Best Buy and launches its first superstore in 1983. Best Buy grew rapidly between 1984 and 1987; it expanded from eight stores to 24 and its sales jumped from \$29 million to \$240 million.<sup>2</sup> In 1985, the company successfully raised \$8 million in an IPO on NASDAQ.

To set Best Buy apart from its competitors, Schulze introduced the warehouse-like store format in 1989 and took sales staff off commission. The number of employees per store was reduced by about a third, resulting in significant cost savings. This concept was crucial to

Best Buy's ascent to become the second largest consumer electronics retailer in the U.S. by 1993.<sup>3</sup>

Best Buy continued to expand aggressively in the following years and found itself in a large amount of debt in 1995. In 1997, earnings plummeted and the company realized it had overextended itself with its expansion. The company initiated a massive makeover, scaled back operations and controlled inventory more tightly.

Since then, Best Buy has flourished once again under superior management (see Appendix 1 for biographies). The company implemented innovative concepts in its stores, expanded domestically and internationally, and quickly became the world's leading consumer electronics retailer. As of February 28, 2009, Best Buy is the largest consumer electronics retailer in the U.S. with a domestic market share of 22%.<sup>4</sup> Table 1 details the company's developments since 2000.

<b>Table 1: Best Buy Historical Development since 2000<sup>5</sup></b>	
2000	<ul style="list-style-type: none"> <li>▪ Best Buy entered the online retailing business by launching www.bestbuy.com.</li> <li>▪ Fortune Magazine named Best Buy one of the top 10 performing stocks since 1990.</li> </ul>
2001	<ul style="list-style-type: none"> <li>▪ The company acquired Magnolia Hi-Fi, Inc. for \$87 million.</li> <li>▪ The company entered the international marketplace by acquiring Canada-based Future Shop, Inc. for \$377 million.</li> </ul>
2003	<ul style="list-style-type: none"> <li>▪ The company launched dual-branding strategy in Canada by opening Best Buy stores.</li> <li>▪ Best Buy acquired Geek Squad, Inc. for \$3 million.</li> </ul>
2004	<ul style="list-style-type: none"> <li>▪ Forbes Magazine named Best Buy "Company of the Year".</li> <li>▪ Began testing the customer-centricity operating model in over 50 stores.</li> </ul>
2005	<ul style="list-style-type: none"> <li>▪ Best Buy opened its first Magnolia Home Theatre store-in-store concept. The company later adopted this strategy for Geek Squad as well.</li> <li>▪ The customer-centricity operating model was a success and all stores will transition to this model.</li> <li>▪ Best Buy acquired Audiovisions, Inc. for \$7 million.</li> </ul>
2006	<ul style="list-style-type: none"> <li>▪ Best Buy acquired Pacific Sales, Inc. for \$410 million.</li> </ul>

2007	<ul style="list-style-type: none"> <li>▪ The company purchased majority interest in China's Jiangsu Five Star Appliance Co. Ltd. for \$180 million.</li> <li>▪ Best Buys acquired majority stake in The Carphone Warehouse Group PLC for \$2.1 billion.</li> <li>▪ All remaining U.S. Best Buy stores have completed the transition to the customer-centricity operating model.</li> </ul>
2008	<ul style="list-style-type: none"> <li>▪ Best Buy acquired Speakeasy, Inc. for \$97 million.</li> <li>▪ Best Buy acquired Napster, Inc. for \$121 million.</li> <li>▪ Best Buy expanded Geek Squad to the United Kingdom through the relationship with The Carphone Warehouse.</li> <li>▪ Best Buy and The Carphone Warehouse entered into a joint venture to establish stores in the UK and grow The Carphone Warehouse's existing retail business and introduce Best Buy stores across Europe.</li> </ul>
2009	<ul style="list-style-type: none"> <li>▪ The company opens its first pilot store in Mexico.</li> </ul>

## **Products & Brands**

With operations in four continents, Best Buy is a multinational retailer of consumer electronics, home office products, entertainment software, appliances, and related services. Consumer electronics is Best Buy's largest product category, which includes video and audio equipment such as television sets, DVD players, audio systems, portable audio players, and car stereos. Home office products include personal computers and related peripheral equipment, telephones, cellular phones, copiers and calculators. Entertainment software includes CDs, DVD movies, computer software, and video game hardware and software. Appliances consist of washing machines, dryers, air conditioners, dishwashers, ranges and refrigerators. In addition these four main categories, the company offers residential and commercial computer repair, support, installation and related services.

Best Buy's portfolio consists of a total of 11 brands that are divided into two segments: domestic and international. The domestic segment includes the U.S., while the international segment includes Canada, Europe, China and Mexico. The brands include:

1. Best Buy – offers consumer electronics, home office products, entertainment software, appliances, and related services in the U.S., Canada, China and Mexico.
2. Future Shop – a Canada-based retailer that sells similar products as Best Buy.

3. Geek Squad – provides residential and commercial computer repair, support, installation and related services in U.S., Canada, China, and U.K. It operates both within Best Buy stores as well as several standalone stores.
4. Magnolia Audio Video – a Seattle-based, high-end retailer of audio and video products. It operates both within Best Buy stores as well as several standalone stores.
5. Jiangsu Five Star Appliances – the fourth-largest appliance and consumer electronics retailer in China and sell similar a product line as Best Buy.
6. The Carphone Warehouse – Europe’s leading independent retailer of mobile phones and services.
7. Best Buy Mobile – a U.S.-based retailer that sells similar products as The Carphone Warehouse. It operates within Best Buy stores as well as several standalone stores.
8. Pacific Sales – offers kitchen, bath and home improvement products in Southern California.
9. Speakeasy – a U.S.-based provider of broadband, voice, data and information technology services.
10. Audiovisions – a U.S.-based commercial and residential video/audio systems integration firm.
11. Napster – a leading online provider of digital music.

## ***Business Model***

Best Buy’s current business strategy has two primary goals: offering customers the widest range of products at the lowest prices and expanding into new international markets. The company’s recent acquisitions and new business ventures have been in these two directions. The management is positive that these two strategies will allow Best Buy to be in a favorable position to grow domestically and internationally.

### Customer-Centricity Operating Model

Best Buy’s success thus far is a testament to its commitment to “treat customer as unique individuals [and] meeting their needs with end-to-end solutions.”<sup>6</sup> Since 1989, Best Buy prides itself as one of the earliest retailers to adopt the strategy of non-commissioned

employees to give customers more control during the purchasing experience. In 2004, Best Buy began implementing an innovative strategy it calls customer-centricity in its stores. Through these strategies, Best Buy has differentiated itself as a store that provides mid- to high-end electronics and entertainment systems and excellent customer service.

The customer-centricity operating model views Best Buy as a portfolio of customers rather than products. It forces the company to understand its customer base at a deeper level and better target its needs. In 2004, Best Buy tracked its customers' behaviors and identified five initial customer segments that represented significant new growth opportunities. The segments were each given a name<sup>7</sup>:

1. Jill, the busy suburban mom who wants to enrich her children's lives with technology and entertainment.
2. Buzz, the focused, active, younger male customer who wants the latest technology and entertainment.
3. Ray, the family man who wants technology that improves his life – the practical adopter of technology and entertainment.
4. Barry, the affluent professional who wants the best technology and entertainment experience and who demands excellent service.
5. BB4B (Best Buy for Business), the small business customer who can use Best Buy's product solutions and services to enhance the profitability of his or her business.

Best Buy tested out these segments at 32 U.S. stores by training and empowering employees to better meet these customer segments' needs. It allowed employees large discretion in making the store more appealing to their particular customer segment. The results were astounding. The lab stores sales were an average of 7% higher than other U.S. Best Buy stores. Close rates (the percentage of shoppers who make a purchase) also rose by approximately 6%.<sup>8</sup> SG&A for the stores were expectedly higher, but the model helped lower employee turnover from 81% in 2005 to 69% in 2006.<sup>9</sup> The company decided to adopt this strategy with all of their stores and the transition was fully completed in 2007. To this day, Best Buy continually revises the customer segments in order to capture new growth opportunities.

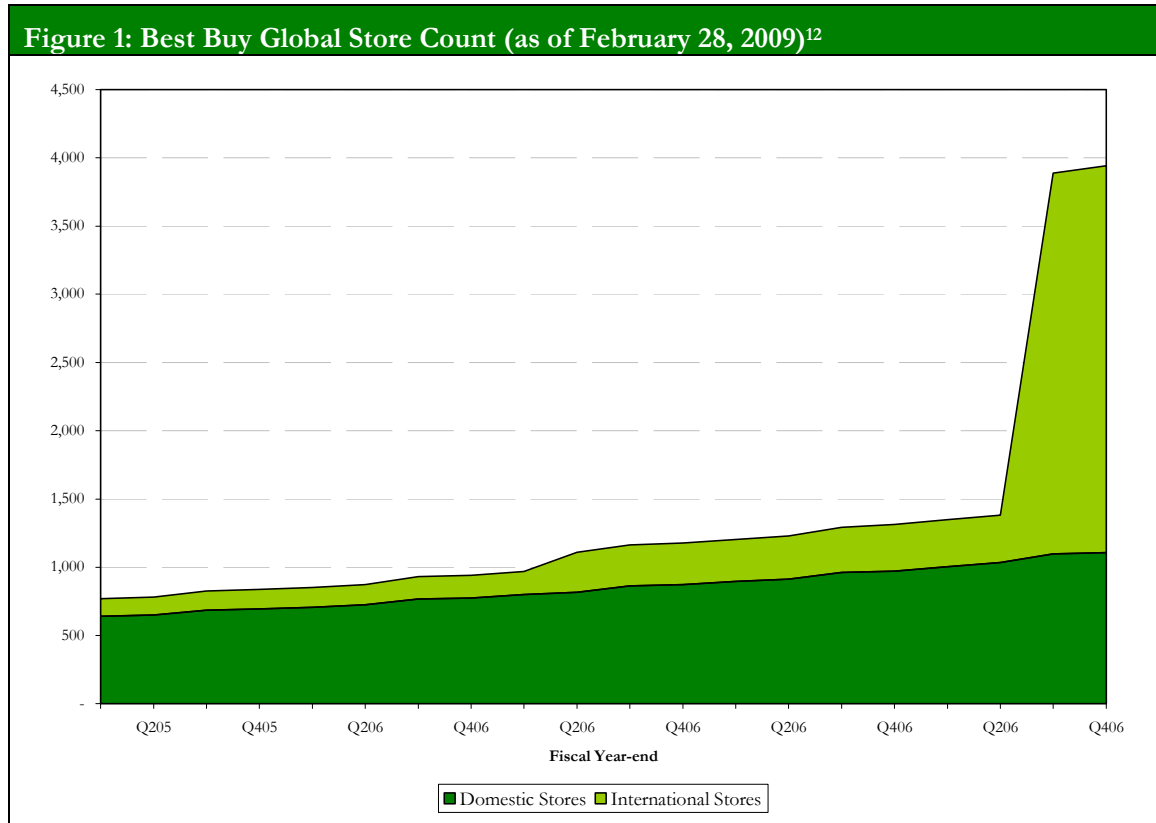


### Cross Industry Expansion

Since 2000, Best Buy has acquired entire or majority stakes in nine companies that complement its existing products, services and culture. These acquisitions, over \$3 billion in combined value, expanded the company's operations into Canada, China and Europe. Additionally, they added a wide range of products such as kitchen and bath appliances, broadband technology, and repair services to Best Buy's existing portfolio. Beginning in 2008, Best Buy has been focused on strengthening its market position by expanding into the cellular phone sales to compete with its rivals. Best Buy entered into a joint venture with U.K.'s largest cellular phone retailer, The Carphone Warehouse to open new Best Buy Mobile stores in the U.S. Furthermore, its acquisition of Napster launched Best Buy into an entirely different market of digital media distribution. To help drive Best Buy Mobile's expansion, the management intends to enhance service plans with Napster's distribution platform and mobile capabilities.<sup>10</sup> Best Buy hopes to increase the company's share of the 160 million handset market in the U.S. to 10% in under five years from about 4% currently.<sup>11</sup>

### Aggressive Store Growth

The expansion of retail stores for Best Buy plays a significant role in its revenue growth and success. For FY09, Best Buy operated just shy of 4,000 retail stores worldwide. Over the past decade, Best Buy has almost doubled the number of stores domestically every five years. Majority of international store growth comes from the acquisitions of The Carphone Warehouse and Five Star Appliances. Additionally, the company opened a Best Buy store in Shanghai and a pilot store in Mexico. Figure 1 shows the addition of new stores domestically and internationally over the last five fiscal years. Table 2 shows the breakdown of stores.



**Table 2: Best Buy Global Store Breakdown (as of February 28, 2009)<sup>13</sup>**

Store Type	U.S.	Canada	China	Mexico	Europe	Acquire Year
Best Buy	1023	58	5	1	0	N/A
Future Shop	0	139	0	0	0	2001
Magnolia AV	6 (standalone)	0	0	0	0	2001
Geek Squad	6 (standalone)	0	0	0	0	2003
Pacific Sales	34	0	0	0	0	2007
Five Star Appliances	0	0	164	0	0	2007
The Carphone Warehouse	0	0	0	0	2465	2008
Best Buy Mobile	38 (standalone)	3	0	0	0	2008

### Distribution

The distribution system is crucial to Best Buy's operations in order to meet its customer needs. Generally, U.S. Best Buy stores' merchandise, except for major appliances and large-screen televisions, is shipped directly from manufacturers to the distribution centers located in California, Georgia, Indiana, Minnesota, New York, Ohio, Oklahoma and Virginia. Major appliances and large-screen televisions are shipped to satellite warehouses in each major market. The distribution system in the international segment operates similarly. The Canada stores' merchandise is shipped directly from the suppliers to the distribution centers in British Columbia and Ontario. Five Star Appliances stores' merchandise are received and warehoused at more than 50 distribution centers and warehouses. The China Best Buy store's merchandise is shipped directly from the suppliers to the distribution center in Shanghai. In order to meet release dates for selected products and to improve inventory management, certain merchandise is shipped directly to the stores from manufacturers and distributors.

### Suppliers

In fiscal year ended March 2008, the 20 largest suppliers accounted for just over 60% of the merchandise purchased, with five suppliers — Sony, Hewlett-Packard, Samsung, Apple, and Toshiba — representing just over one-third of total merchandise purchased.<sup>14</sup> Best Buy generally does not have long-term written contracts with the major suppliers. The company, however, has not experienced significant difficulty in maintaining satisfactory levels of supply.

Best Buy operates global sourcing offices in China in order to purchase products directly from manufacturers in Asia. These offices have improved the product sourcing efficiency and provided the company with the capability to offer private-label products that complement the existing product line. In the future, the company expects purchases from the global sourcing offices to increase as a percentage of total purchases.<sup>15</sup>

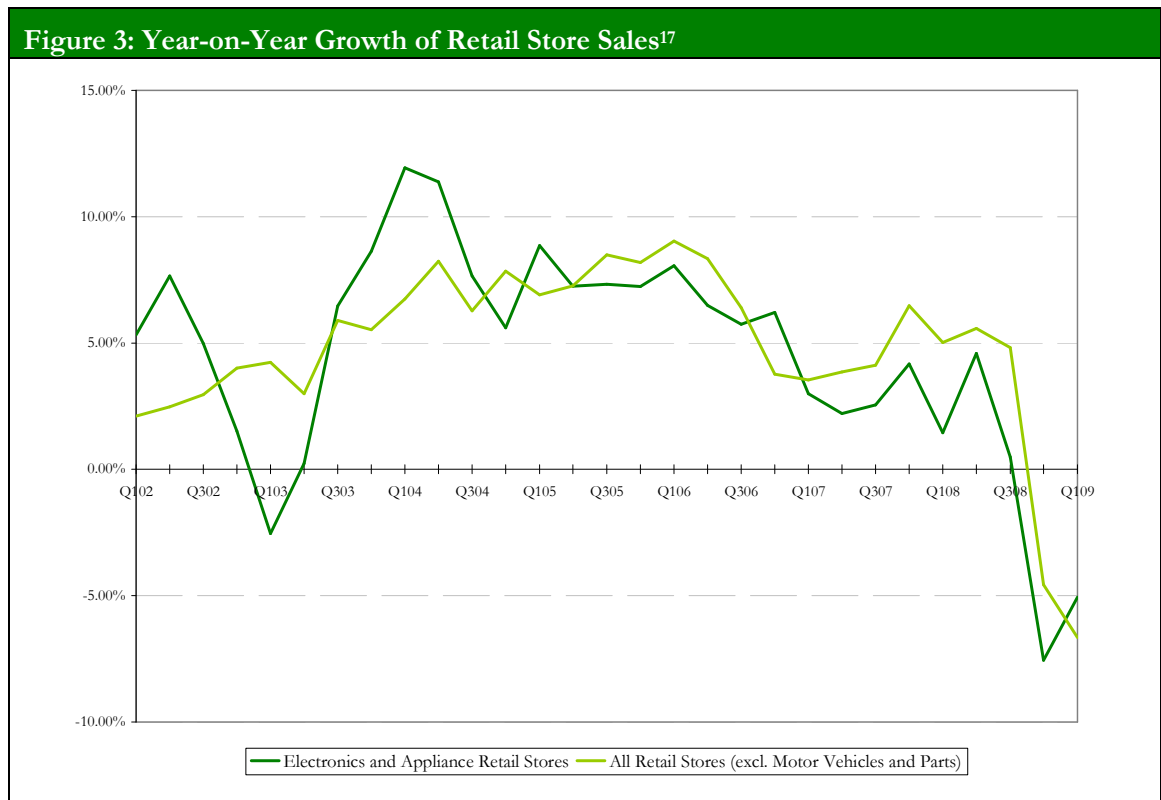
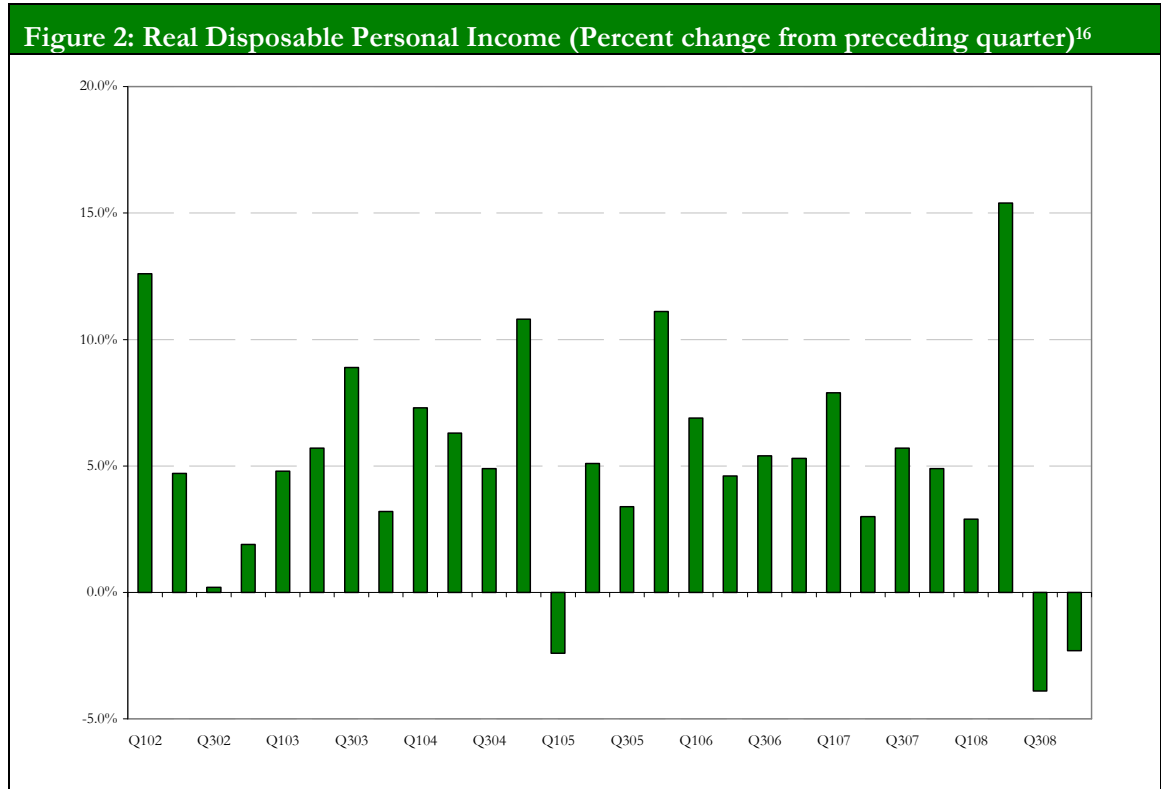
## **Market Overview**

### Economic Outlook

With the current housing and credit crisis still unfolding, there is very little reason to believe that there will be any drastic rebound in the immediate future. In the U.S., Americans have been borrowing and spending liberally for years against their home values, which have now fallen and are dragging consumption down with them. Disposable personal income is widely considered as a driving force behind personal consumption. The more disposable income a consumer has, the more they are willing to spend on otherwise unnecessary products or services. After almost six years of positive growth in real disposable personal income, the Bureau of Economic Analysis recorded negative growth rates during the third and fourth quarters of 2008 (see Figure 2).

The decrease in disposable income was felt pretty strongly in the U.S. retail sector. According to the Census Bureau, retail store sales (excluding motor vehicles and parts) year-on-year (YoY) growth rates have been hovering between 4% and 9% from 2003 to the third quarter of 2008 (see Figure 3). By the fourth quarter of 2008, retail store sales recorded YoY decrease of 4.57%. This figure continued to fall during first quarter of 2009 to -6.66%. Clearly, individuals in the U.S. began to feel their disposable income shrink and slowed down their spending. According to the Census Bureau, YoY growth rates for electronics and appliance retail store sales were already beginning to fall since the first quarter of 2008. It is not surprising since electronics and appliances are typically viewed as luxury goods.

The current economic environment will certainly be a challenge for Best Buy. The management will have to be cautious going forward and implement a different set of strategies to cope with the fall in consumer spending.



### Competitive Landscape

For many years, Best Buy's most direct competition comes from Circuit City, the second largest consumer electronics retailer behind Best Buy. Circuit City's business has been struggling since 2006 and filed for bankruptcy protection in November 2008. Circuit City was forced into liquidation by March 2009. The company stands to gain lot from Circuit City's demise. According to one research report, Best Buy would be able to capture as much as 40% of Circuit City's market share.<sup>18</sup>

With \$45 billion in revenue for the fiscal year ended February 28, 2009, Best Buy is the largest consumer electronics retailer in the world. No other pure consumer electronics retailer comes even close to Best Buy's size and performance. RadioShack, currently the second largest consumer electronics retailer recorded \$4.2 billion in revenue for the fiscal year ended December 31, 2008.<sup>19</sup> Despite the lack of immediate comparable rivals, Best Buy still faces a wide array of indirect competitors:

1. Unspecialized discount retailers such as Wal-Mart, Target and Costco.
2. Online retailers such as Dell, Amazon.com, and eBay.
3. Entertainment software stores such as GameStop.
4. Office supply stores such as Staples, OfficeMax, and Office Depot.
5. Home improvement retailers such as Home Depot and Lowe's.
6. Small retailers with little overhead (including internet vendors).

While Best Buy has no direct competition, but has a many rivals in each of its product categories.

## Competitive Analysis

Force	Strategic Significance
Internal Rivalry	HIGH
Threat of New Entrants	LOW
Threat of Substitute Products	MODERATE
Bargaining Power of Buyers	LOW
Bargaining Power of Suppliers	MODERATE to HIGH

### ***Internal Rivalry***

Internal rivalry is the most significant force of Porter's Five Forces and is very high among in the consumer electronics retail industry. According to Yahoo Finance, there are approximately 7 major companies that are traded publically and sell predominately electronic products. There are also numerous privately-held retailers that serve specific niche markets. With a market capitalization of over \$16 billion, Best Buy is the dominant player in this industry. Competition, however, comes from companies outside of this industry. Discount retailers such as Wal-Mart, Target and Costco occupy a significant part of the consumer electronics market. Wal-Mart, for example, booked \$378 billion in sales in FY08 and its \$92.2 million in gross profit more than double Best Buy's \$40 billion in revenue during the same period.<sup>20</sup> Wal-Mart does not breakdown its sales into different product categories, so it is not possible to directly compare the two businesses. However, even if consumer electronics was merely 1% of Wal-Mart's \$378 billion operation, it would still be very significant to Best Buy. Competition is high primarily because there is little to no switching costs if a buyer chooses to shop elsewhere. Furthermore, the products are not differentiated: buyers can get similar products at almost all of the different electronic stores. As a result, companies compete on prices and non-tangibles, such as customer service and goodwill.

An important observation of the market is its net profit margin (NPM). The NPM shows how much profit a company makes after taxes for every dollar it generates in revenue. According to Yahoo Finance, the NPM of the consumer electronics retail market is low

(3.80%). This implies that competition is quite fierce, and profitability and survival is depended on inventory turnover. Circuit City had to liquidate its assets because it was not able drive sales as effectively as other competitors over the past several years. Combine the level of competition with the current economic conditions, many companies in the industry must find it more difficult to continue operations as they did in the past several years.

### ***Threat of New Entrants***

The threat of potential new entrants into the consumer electronics retail industry is relatively low. The market capital of the industry, according to Yahoo Finance, is currently at \$23.2 billion. This figure is substantially lower than other industries such as Apparel Stores (\$37.2 billion), Home Improvement Stores (\$53.0 billion) or Discount Variety Stores (\$240.4 billion). The low market capitalization implies that it would not be difficult to enter the industry based solely on the capital required. However, a potential entrant would have to overcome the superior brand reputation that Best Buy has established. Best Buy has built a reputation for selling mid- to high-end product and excellent customer service. It would be difficult for an entrant to challenge the company. Furthermore, it would be difficult to undercut incumbent firms who have already established relationships with suppliers to purchase merchandize at the lowest prices.

Although the threat of entry is low, the potential pool of entrant is actually quite large as it consists of numerous online electronics retailers. These online retailers are the most likely candidate to enter the consumer electronics retail market because they already have large existing inventories and extensive experience dealing with customers – two key factors that give them a potential edge. The fact that they are currently only online retailers suggests that acquiring real estate is a significant entry barrier. However, once an online retailer is able to establish a strong reputation with customers, it is likely to enter the industry to captures additional sales through non-web customers. As mentioned, the NPM of the industry is low (3.80%). This means that a key component to be successful in this industry is to drive sales and have high inventory turnover. High inventory turnover implies that large inventories are



required in warehouses. Together, these two factors make a very significant barrier to entry for potential entrants.

### ***Threat of Substitute Products***

The substitute products that may take a portion of the market share away from the consumer electronics retail industry do not pose a huge or direct threat. Today's society and culture places a lot of emphasis on technology and is highly dependent on electronics. As a result, there are few substitutes for electronics that will directly take their place, such as books, magazines and other non-electronic hobbies to occupy people's time. Some of the main retailers of books are Barnes and Noble, Borders and the online retailer Amazon.com.

### ***Bargaining Power of Buyers***

The bargaining power of buyers for electronic products is extremely low because the buyers primarily consist of a weak and fragmented group of individuals. There are several reasons for this:

1. The purchase volume is very low. Most people do not go to Best Buy and purchase 10 HD TVs or 10 DVD players, for example. The typical individual will purchase one item of a specific product. So the buyers often do not have any influence on prices.
2. The cost of buying electronic products is not a huge percent of a buyer's budget, unlike purchasing a house or car. Also, there is no intense competition between buyers for any one brand (i.e. Sony, Panasonic, Samsung, and etc.).
3. Because electronic products are often a luxury rather than a necessity, buyers do not generally have a say in what products get produced and at what price.
4. Most importantly, buyers do not have the ability to integrate backwards because it is not feasible for individuals to build their own electronic products or establish their own retail shops.

As a result, the buyers in the consumer electronics retail market do not have any substantial bargaining power over the companies in the market and do not have any substantial influence on the products or prices.

## ***Bargaining Power of Suppliers***

The suppliers for companies in the market have relatively high bargaining power mainly due to the fact that there are only a number of suppliers that the market demands from. Among the pool of suppliers include major manufacturers such as Sony, Samsung, LG, Panasonic and Toshiba. These suppliers provide the latest state-of-the-art technology and companies like Best Buy must purchase from them in order to keep its inventory fresh and satisfy its customers. There is no way around purchasing these products; for example, backward integration is difficult and requires a lot of capital and technological expertise. This suggests that suppliers have a substantial influence on the products that they manufacture and their pricing. Furthermore, the high bargaining power of the suppliers is also due to the sheer number of stores that they are in. Therefore, consumer electronics retailers must purchase them to stay competitive in the industry.

On the other hand, there are several factors that lower the bargaining power of the suppliers. While most of all the suppliers have their own online stores to drive sales, they rely almost entirely upon retailers to bring in revenue. Suppliers want their products on the shelves for people to see and test them. They also rely on the sales teams within retail stores to help drive sales. Therefore, a company can partially mitigate the bargaining power of a supplier if it is especially effective in bringing sales. Best Buy, as the industry leader, therefore has more bargaining power than other retailers. Additionally, while there might not be intense competition between buyers for any one brand, there is intense competition among the suppliers. For example, the most recent Blu-ray and HD-DVD rivalry between Sony and Toshiba caused less bargaining power for these suppliers.

## SWOT

### **Strengths**

#### Demonstrated financial strength

Best Buy has consistently recorded strong growth. The company's revenue grew at a CAGR of 9.90% during FY05-08, from \$27 billion to \$40 billion. Operating profit grew tremendously at a CAGR of 10.64% during FY05-08 from \$1.4 billion to \$2.1 billion. Also net income increased by a CAGR of 9.35% during the same period, from \$980 million to \$1.4 billion. The increase in net earnings was driven by revenue growth and a decrease in selling, general and administrative expense rate, offset by a decrease in gross profit rate and a higher effective income tax rate. With the huge increase in its operating and net profits over the years, the company strengthened its financial position in the market.<sup>21</sup>

#### Reputable Brand Name

Best Buy is recognized as one of the best companies in the world because of its sound management. In 1993, the company became the second largest consumer electronics retailer and in 2000, Fortune magazine named it one of the top 10 performing stocks. Best Buy was named company of the Year by Forbes magazine in 2004, Specialty Retailer of the Decade by Discount Store News in 2001, ranked one among the Top 10 America's Most Generous Corporations by Forbes magazine and made Fortune Magazine's List of Most Admired Companies in 2006.

#### Expansive Store Coverage

Over the years, Best Buy has built a name for itself through offering a wide selection of products and excellent services. This has allowed Best Buy to open many stores both domestically and internationally during the past several years. At the end of FY09, the company operated approximately 1,100 domestic retail stores. On the international front, the company operated approximately 3,000 stores. Going forward, the company plans to open more stores in new countries such as Turkey and Mexico.

## **Weaknesses**

### Dependence on United States market

Although Best Buy has international operations in China, Europe and Canada, the company mainly derives its revenues from the U.S. market. About 83% of the company's total revenue comes from the U.S. Furthermore, the company relies heavily on the sales of consumer electronic products. Therefore, this high market concentration in the U.S. can result as a big disadvantage for the company in the long-run as consumer electronic products decrease from 42% in 2007 to 41% in 2008 in the revenue mix. It could significantly affect the revenues of the company and also its expansion opportunities if it continues to focus only in the U.S. market. Best Buy needs to further diversify its revenue generating sources.

### Dependence on select number of vendors for its merchandise

Best Buy mainly depends on a handful of vendors for the supply of their products. Best Buy's 20 largest suppliers account for just over 60% of the merchandise it purchases. If any of key vendors fails to supply products or if there is any disruption and loss from any vendors the company may not be able to meet the demands of the customers which can result in the decline of revenues.

## **Opportunities**

### New ventures

The recent joint venture between Best Buy and The Carphone Warehouse is an exciting opportunity for the company to expand into new geographic locations in Europe. The consumer electronics market has been one of the fastest-growing industries in the European market over the past five years.<sup>22</sup> The management will have to be careful in this expansion and try not to overextend its resources.

### Bankruptcies

Best Buy's largest competitor, Circuit City, filed for bankruptcy at the end of 2008 and is closing 155 stores. This will prove to be tremendous opportunity for Best Buy to gain market share as competitors scramble to fill the void left by Circuit City. Many other

consumer electronic stores have also filed for bankruptcy. Tweeter, a high-end rival, shut down in December 2008, and Sharper Image's stores, which sold more exotic electronics, have liquidated. CompUSA closed most of its stores in 2007. As the weaker players in this market are weeded out, Best Buy must be actively seeking to gain those market shares.

## **Threats**

### Deteriorating Economic Conditions

Best Buy sells products and services that consumers tend to view as luxury goods rather than necessities. Therefore, the company is more sensitive to changes in general economic conditions that impact consumer spending. Future economic conditions and other factors including consumer confidence, employment levels, interest rates, tax rates, consumer debt levels, fuel and energy costs and the availability of consumer credit could reduce consumer spending or change consumer purchasing habits. A further deterioration of the U.S. economy or the global economy could adversely affect consumer spending habits and thus Best Buy's earnings.

### Highly Competitive Market

The retail business is highly competitive. Best Buy faces competition regarding its customers, employees, locations, products and other important aspects of business with many other local, regional, national and international retailers. Furthermore, there are numerous internet retailers that sell similar products that Best Buy does. These internet competitors may have a smaller market presence and financial resources, but their prices are substantially lower because of lower overhead. This competition could force Best Buy to reduce its products' prices or increase costs of doing its business. As a result of this competition, the company may experience lower revenue and higher operating costs. Best Buy will have to do its best to differentiate itself from these internet competitors.

### Flat panel TVs saturation

Despite what is now believed to be nearly a 50% penetration rate in digital TVs, it seems that the market will soon hit its saturation point.<sup>23</sup> This could potentially be a problem for Best

Buy since it derives most of its revenues from TV sales. To add to the problem, discretionary spending is clearly slowing and higher ticket OLED TVs appear to be at least a couple of years away before being widely available in large screen sizes. In the meantime the recent introduction of 240 Hz LCD TVs (second derivative of the 120 Hz LCD TVs), will create excitement for the consumer.

## Financial Analysis

### Overview

Best Buy is the largest U.S. consumer electronics retailer with 22% of the domestic market share in the U.S. Revenue in FY09 increased 12.5% to \$45 billion, from \$40 billion in 2008; operating profit fell to \$1.74 billion, an 18.6% decrease from \$2.16 billion in 2008; net income drop to \$1 billion, a 28.7% decrease from 2008. This yields an EPS of \$2.39 compared to \$3.12 in 2008. The increases in revenue reflect market share gains and the addition of new stores domestically and internationally. The drop in operating profit and net income is a result of non-operating impairment charges and increased SG&A for the fiscal year.

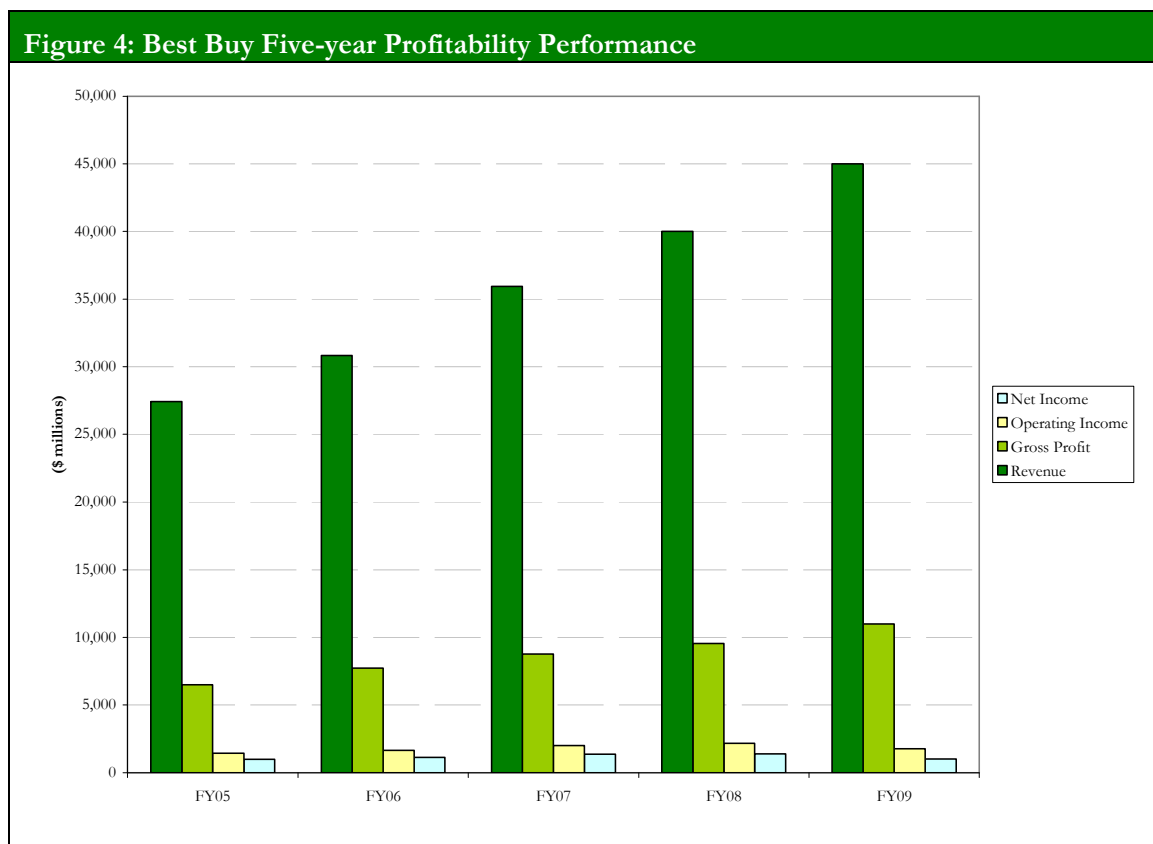
Best Buy ended the fiscal year with a cash balance of \$498 million vs. \$1.44 billion last year, due primarily to the payment for the stake in The Carphone Warehouse. The company also ended with \$1.963 billion in outstanding debt vs. roughly \$816 million last year, again due largely to the acquisition of The Carphone Warehouse.

Amazon.com, Wal-Mart and GameStop are Best Buy's three most relevant competitors at the moment. Table 3 shows a comparison of the key financial numbers among these companies. The reader should be cautious when interpreting these figures as it is not possible to compare these businesses directly.

Table 3: Key Competitors Financial Comparison <sup>24</sup>						
Company	Market Cap. (in bln.)	Revenue Growth (TTM)	Operating Margin (TTM)	EPS (TTM)	Debt/Equity (MRQ)	Return on Assets (TTM)
Best Buy	\$16.53	12.47%	3.91%	\$2.39	42.28%	7.18%
Amazon.com	\$33.82	29.19%	4.39%	\$1.49	17.51%	8.84%
Wal-Mart	\$194.98	7.17%	5.62%	\$3.35	64.67%	8.41%
GameStop	\$4.90	24.13%	7.64%	\$2.38	23.73%	9.61%
Competitor Average	\$77.90	20.16%	5.88%	\$2.41	35.30%	8.95%

## Profitability and Growth

Best Buy's sales revenue grew at a CAGR of 10.41% over the past five years, from \$27 billion in FY05 to \$45 billion in FY09. Gross profit posted a healthy CAGR of 11.11% over the same period. The company's top-line growth was impressive, but operating income (CAGR of 4.05%) and net income (CAGR of 0.38%) did not show similar results.<sup>25</sup> Figure 3 summarizes Best Buy's profitability performance over the past five years. The lower growth in operating income and net income is partly due to higher SG&A expenses.



The product category mix was: consumer electronics (41%), home office (28%), entertainment software (19%), appliances (6%) and services (6%).

Comparable store sales (comps) in each of the product categories reveal interesting trends (see Appendix 2.1-5). In the consumer electronics category, comps decreased 8.6% vs. a decrease of 4.6% last year. Sales were sluggish in digital cameras, MP3 players and GPS



products. In the home office category, comps trended positively and grew 8.1%. Computer and mobile phones sales were particularly strong in this category. Entertainment software comps posted a decline of 11% vs. a 2.2% increase last year. This was primarily due to sluggish DVD and CD sales. In the appliances category, comps decreased tremendously by 20.5% vs. a decline of 2.9% last year. Services comps have been posting positive gains since Q107 and increased by 2.2% this year.

## **Solvency**

As shown in Table 3, Best Buy's debt to equity ratio of 42.28% is relatively high compared to the selected competitors. Only Wal-Mart had a higher debt to equity ratio at 64.67%. The primary reason that Best Buy's debt to equity ratio is higher than its competitors is Best Buy has been aggressively expanding domestically and internationally. Best Buy's outstanding debt doubled between last fiscal year and this fiscal year. The debt was used to launch new stores and make acquisitions. While its expansion is important, Best Buy's management must make sure the debt does not grow out of control as it did back in 1995.

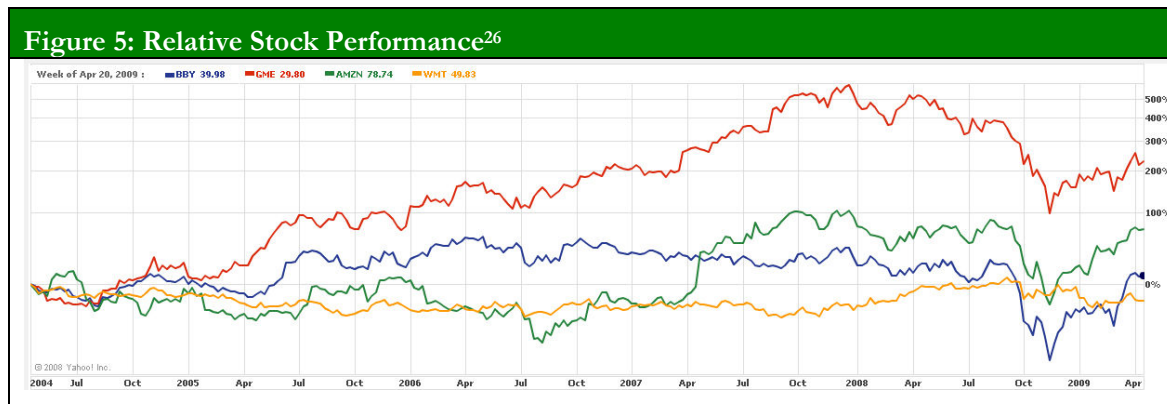
## **Liquidity**

Best Buy's current ratio for the most recent quarter was 0.97. This indicates that the company's liquidity position is adequate, but it could be better. It is important for companies to have a current ratio of at least one. Best Buy's competitors, Amazon.com, Wal-Mart and GameStop, have current ratios of 1.30, 0.88 and 1.16, respectively. This put Best Buy in the middle of the pack.

## **Stock Chart**

Best Buy's stock performance over the past five years was not as strong as some of its competitors (see Figure 4). For the most part, the company's stock price had been trending positively primarily due to strong revenue growth and bottom-line return. However, beginning August 2008, like most companies, Best Buy's stock price plummeted due to the unfavorable economic climate. The stock price fell not because Best Buy's fundamentals were unsound but because the market panicked and triggered a general selloff.

The stock price of Best Buy began to increase steadily since November. There were several reasons behind this rally. First, when Circuit City filed for bankruptcy protection in November, it meant that Best Buy stood to gain a lot of market share. Second, investors were optimistic that Best Buy would capture more sales during the holiday season since Circuit City was out of business. Finally, Best Buy exceeded market expectations as sales held up better than predicted despite the recession. The management was able to consistently surprise analyst estimates over the past five quarters.



## Strategic Recommendations

### Challenges

Oasis Consulting has identified two challenges that Best Buy will face going forward. First, it is unlikely that the U.S. economy will rebound to the levels that it had been experiencing for at least another couple years. As housing prices continue to fall and lower people's wealth, so will consumer discretionary spending. As shown in Figures 2 and 3, the amount of disposable income individuals have is closely related to retail sales growth. For Best Buy, this is very problematic since its products are viewed as luxury goods and otherwise unnecessary. The second problem Best Buy will face is increased long-term competition from its discount competitors like Wal-Mart, Amazon.com and other internet retailers. The shakeout in the consumer electronics retail industry has left only several players standing and competition will intensify as companies seek to gain market share. Furthermore, as internet retailing becomes easier and ubiquitous, Best Buy will stand to lose all of its business if it does not reassess its business model. In short, Best Buy needs to address the following questions:

1. How can Best Buy support the anticipated fall in sales due to contracting consumer spending in the short term?
2. How can Best Buy compete with large discount competitors like Wal-Mart and Target as well as internet discount retailers like Amazon.com?

Oasis Consulting have developed several solutions to cope with issues above and strongly advises the management of Best Buy to consider them.

### Short-Term Solutions

#### Increase Services Category's Contribution to Revenue Mix

Best Buy is a retailer of luxury goods. When consumer spending is falling, the company will undoubtedly experience a slowdown in sales growth. Since Best Buy derives almost 40% of its revenue from the consumer electronics category, Best Buy needs to try to reduce this reliance and increase the other category's contribution. Specifically, Oasis Consulting urges

the management to review the services category as it is currently under utilized. Even after having acquired Geek Squad for almost seven years and carving out Geek Squad sections in all of its stores, services category still only account for about 6% of total revenues generated. This is the perfect opportunity to advertise Geek Squad services and strengthen Best Buy's commitment to excellent technology support services. Oasis Consulting believes that Geek Squad will help Best Buy through the slump in sales with more consumers looking to fix or improve their existing products, rather than buying new ones.

#### Tie-in Home Installation Services

Best Buy offers home installation services for video and audio systems through several venues: Best Buy in-store employees, Magnolia Audio Video standalone stores and Magnolia Home Theatre centers within Best Buy stores. These installation services have very high margins for the amount of labor involved. Furthermore, these services will be highly desired by those who are not technologically savvy. The management should ramp up efforts to sell these services to customers to help bolster top-line revenue. One possibility is for Best Buy to bundle-in products that would require installation services, such as TV wall mounts, DVRs or DVD players when customer purchases video and audio equipment. Since customers usually tend to upgrade technology in stages rather than all at once, another possibility is offering an installation services loyalty program. The advantage of this is twofold: the customer comes back to Best Buy for a product and the installation if necessary.

#### Slow Down Expansion Efforts

Best Buy's outstanding debt more than doubled during FY08-09. Understandably, this was primarily due to the acquisition of The Carphone Warehouse. While it is important for the company to expand its operations even further around the world, it might be prudent to reign in its expansion efforts in the short-term. With economies still trying to grapple with the gravity of the global credit crunch, it is not clear how consumer spending will affect Best Buy in the next couple quarters, so the company might need some financial buffer. Oasis Consulting is recommending that the management be cautious during the expansion process and control costs.

## ***Long-Term Solutions***

### Commitment to Provide Mid- to High-End Products

It is imperative that Best Buy differentiate itself from the product space in which Wal-Mart, Target and Costco over the past several years have placed themselves, namely low-end consumer electronics. Attempting to compete with these large discount retailers in their playing field is to engage in a price war that Best Buy would bound to lose. Best Buy is simply too small in relative comparison and does not have other non-electronics-related product lines. Therefore, the company should strengthen its existing reputation and corporate image by committing to provide solely mid- to high-end products. Oasis Consulting advises the management to hone down its products list to replace low-end products with mid- to high-end ones. Best Buy may also want to cater to the interest of those who are technologically savvy – a demographic group that discount retailers like Wal-Mart would never be able to capture.

### Focus Best Buy Store by Eliminating Appliances

As mentioned in the report, the appliances category have been posting negative comps and only represents 6% of the revenue mix. Oasis Consulting recommends that the management gradually phase out appliances and move the product line to Pacific Sales, where they are more appropriate. Not only do home appliances deviate from Best Buy's image as a one-stop-shop of technological products and services, but it requires Best Buy stores to compete with home improvement retailers such as Home Depot and Lowe's. Moving the appliance category to Pacific Sales also will help better serve its customers' needs. On the other hand, the floor space freed up in the Best Buy store can be used to expand the existing product lines or develop new store-in-store concepts.

### Reinvent the Best Buy "Shopping Experience"

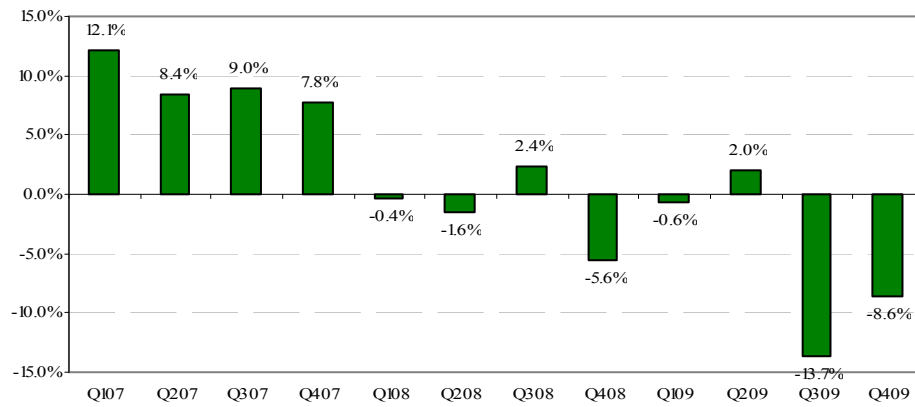
Another major concern for Best Buy is internet retailers. From the well-established Amazon.com to individuals on eBay, the internet has made it easier to connect buyers and sellers. As internet retailing becomes more accessible to even those who are not technologically savvy, Best Buy will become all but obsolete. Furthermore, internet retailing

will almost always be less expensive for customers because of lower overhead costs. In order to survive this paradigm shift, Best Buy must reshape the look and feel of its advertisements and stores. More importantly it needs to sell a “shopping experience” that cannot be imitated online. Therefore, Oasis Consulting advises the management to abandon the warehouse superstore format to a showroom or exhibit format. One possibility is for the products to be laid out in different types of showrooms for customers to interact with. The concept is similar to an Apple store, but at a much larger scale and incorporating a wider range of products. The existing customer-centricity model would still exist, but the emphasis would be shifted to selling a lifestyle rather than a profile. Another possibility is to add coffee shops, game rooms, music rooms and etc. that all utilize products that are sold by Best Buy. The advantage of doing this is to increase the customers’ duration in the store and thus increase the chances of closing a sale. Oasis Consulting believes rethinking the retail experience to make it more personable and physically interactive is a viable way to compete with internet retailing.

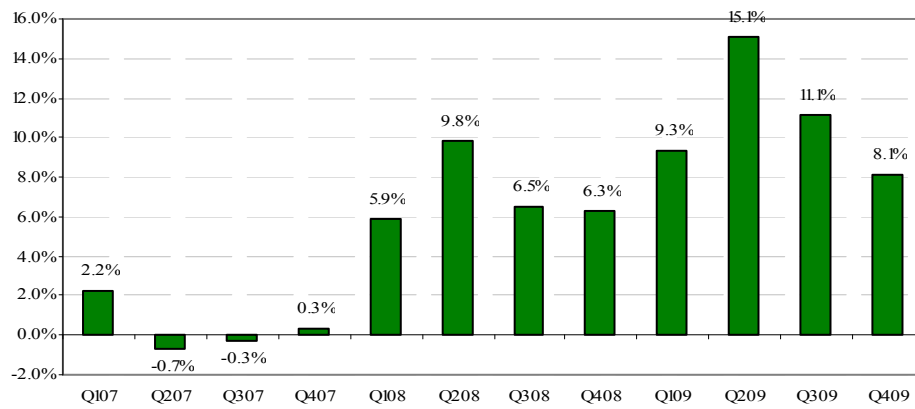
## Appendix

Appendix 1: Key Management Biographies <sup>27</sup>	
<p>Bradbury H. Anderson            Job Title:Chief Executive Officer,Director,Vice Chairman            Board Level:Executive Board            Since:            Age:58</p>	<p>Mr. Anderson is the Vice Chairman, Chief Executive Office and a Director of Best Buy Co, Inc. Prior to that, he served as the President and the Chief Operating Officer of the company since April 1991. In addition, he serves as the Chairman of the board of the Retail Industry Leaders Association, as well as on the boards of the American Film Institute, Junior Achievement, Minnesota Public Radio and Waldorf College.</p>
<p>Brian J. Dunn            Job Title:Chief Operations Officer,President            Board Level:Senior Management            Since:2008            Age:47</p>	<p>Mr. Dunn has been the President and the Chief Operating Officer Best Buy Co, Inc. since February 2006. Prior to his promotion this, he was the President, Retail, North America since December 2004. He has held positions such as the Executive Vice President, the Senior Vice President, the Regional Vice President, the Regional Manager, the District Manager and the Store Manager. He serves on the board of Dick's Sporting Goods, Inc.</p>
<p>James L. Muehlbauer            Job Title:Chief Financial Officer,Executive Vice President            Board Level:Senior Management            Since:2008            Age:48</p>	<p>Mr. Muehlbauer has been the Chief Financial Officer and the Executive Vice President of Best Buy Co, Inc. since April 2008. Previously, he served as the Enterprise Chief Financial Officer (Interim), Chief Financial Officer, Best Buy U.S., the Senior Vice President, Finance and the Vice President and Chief Financial Officer, Musicland. Prior to joining the company, he spent 10 years with The Pillsbury Company, a consumer packaged goods company, where he held various senior-level finance management positions, including the Vice President and the Worldwide Controller, the Vice President of Operations, the Divisional Finance Director, the Director of mergers and acquisitions and the Director of internal audit.</p>
<p>Susan S. Grafton            Job Title:Controller,None,Vice President            Board Level:Senior Management            Since:2008            Age:51</p>	<p>Mrs. Grafton has been the Chief Accounting Officer, the Vice President and the Controller of Best Buy Co, Inc. since December 2008. She joined the company in 2000 and has held many positions such as the Vice President, Financial Operations and the Controller, the Vice President, Planning and Performance Management, a Senior Director and a Director. Prior to joining the company, she was with The Pillsbury Company and Pitney Bowes, Inc. in numerous finance and accounting positions. Currently, she serves on the Finance Leaders Council for the National Retail Industry Leaders Association and the Financial Executive Council for the National Retail Federation.</p>
<p>Richard M. Schulze            Job Title:Chairman,Director,None            Board Level:Executive Board            Since:            Age:67</p>	<p>Mr. Schulze is the Chairman, a Director and a Founder of Best Buy Co, Inc. Currently, he serves on the board of the University of St. Thomas. He is also the Chairman of its Executive and Institutional Advancement Committee. Effective in June 2002, he relinquished the duties of Chief Executive Officer. Further, he also the Chairman of the board of the University of St. Thomas Business School.</p>
<p>Source: Annual Report, Company Website, Primary and Secondary Research            Global Markets Direct</p>	

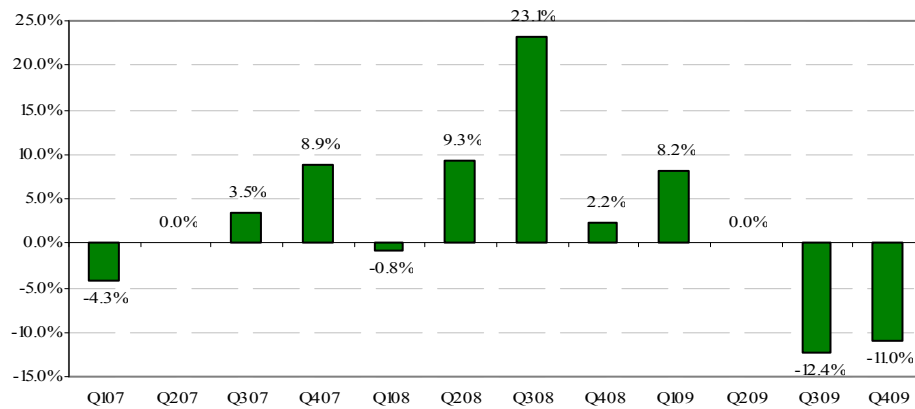
**Appendix [2.1]: Consumer Electronics Comps<sup>28</sup>**



**Appendix [2.2]: Home Office Comps**

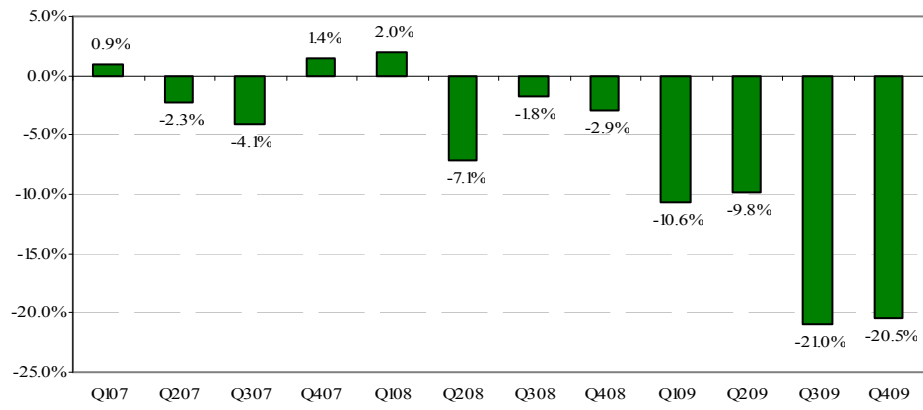


**Appendix [2.3]: Entertainment Software Comps**

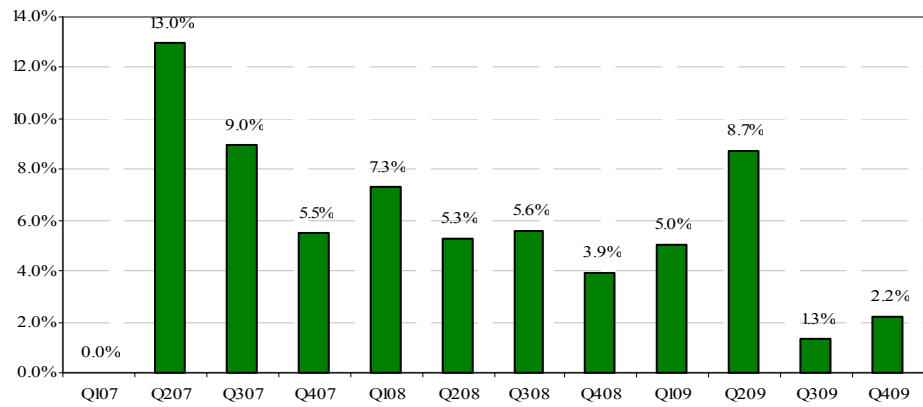




**Appendix [2.4]: Appliances Comps**



**Appendix [2.5]: Services Comps**



## References

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- <sup>1</sup> Reuters
- <sup>2</sup> Best Buy company website
- <sup>3</sup> Best Buy company website
- <sup>4</sup> Best Buy Q409 Quarterly Earnings Report
- <sup>5</sup> Best Buy company website and various news articles
- <sup>6</sup> Best Buy FY08 Annual Report
- <sup>7</sup> Best Buy Press Release, May 3, 2004
- <sup>8</sup> Best Buy Press Release, May 3, 2004
- <sup>9</sup> Boyle, Matthew. "Best Buy's Giant Gamble." FORTUNE 29 Mar. 2006.
- <sup>10</sup> Best Buy Press Release, September 15, 2008
- <sup>11</sup> Cheng, Andria. "Best Buy Seeks To Steal Share In Mobile Market." Dow Jones Newswires 9 Apr. 2009.
- <sup>12</sup> Best Buy Q409 Quarterly Earnings Report
- <sup>13</sup> Best Buy Q409 Quarterly Earnings Report
- <sup>14</sup> Best Buy FY08 Annual Report
- <sup>15</sup> Best Buy FY08 Annual Report
- <sup>16</sup> Bureau of Economic Analysis
- <sup>17</sup> Census Bureau
- <sup>18</sup> William Blair & Company, March 24, 2009
- <sup>19</sup> Reuters
- <sup>20</sup> Reuters
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- <sup>22</sup> JPMorgan, February 12, 2009
- <sup>23</sup> Credit Suisse, February 5, 2009
- <sup>24</sup> Reuters
- <sup>25</sup> Reuters
- <sup>26</sup> Yahoo Finance
- <sup>27</sup> Global Markets Direct, February 2009
- <sup>28</sup> Best Buy FY08 and FY09 Quarterly Earnings Reports