Best Buy (BBY)

Rating	**NEUTRAL***
Price (30 Jul 12, US$)	18.06
Target price (US$)	20.00[1]
52-week price range	28.37 - 17.23
Market cap. (US$ m)	6,138.65
Enterprise value (US$ m)	7,102.68

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

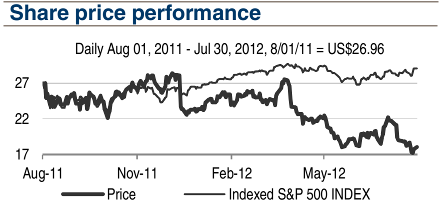
Research Analysts
Gary Balter
Seth Sigman
Simeon Gutman, CFA

COMMENT

Disagreeing With Consensus

- The current consensus on Best Buy is that cash flow is on its way to zero, joining such illustrious retailers as Circuit City, CompUSA, Good Guys and many other consumer electronic chains. We disagree with that for a number of reasons and while we are not changing our rating, we like the idea that this “mismanaged” chain trades at just over 2x cash flow, has over a 20% free cash flow yield and is universally hated by all the smart money.
- Reasons to consider the name: First, this company achieved strong free cash flow with management making significant errors, in our view. These errors include BBY’s failure to develop an Internet presence to compete with Amazon (or anyone online), ignoring the customer experience while being overly focused on stores, letting price become a negative weapon against them, failing to change the company’s compensation structure to commission salespeople (except in BBY mobile), as well as training associates poorly in the store, and not reducing store sizes to create higher service and more effective store formats. Nonetheless, BBY’s position as the largest brick and mortar store has maintained its importance for manufacturers and led to strong cash flow despite itself. Imagine the company’s potential if new management starts correcting some of the many flaws we have highlighted.
- Second, we were encouraged by last week’s announcement that BBY's Canadian stores will match and beat any on line price. We feel this is an obvious strategy to turn store locations from a disadvantage into an advantage. Given BBY's market share, we assume that it will be able to convince suppliers to pay for any price match required. We are pleased with the initiative and await a similar strategy in the US.
- Continued on next page…

Share price performance



On 07/30/12 the S&P 500 INDEX closed at 1385.3

Quarterly EPS	Q1	Q2	Q3	Q4
2012A	0.59	0.34	0.46	2.09
2013E	0.66	0.35	0.45	2.20
2014E	—	—	—	—

Financial and valuation metrics

Year	01/12A	01/13E	01/14E	01/15E
EPS (CS adj.) (US$)	3.39	3.65	3.75	3.86
Prev. EPS (US$)	—	—	—	—
P/E (x)	5.3	5.0	4.8	4.7
P/E rel. (%)	37.3	37.1	40.4	43.6
Revenue (US$ m)	50,041.0	50,235.8	49,981.2	50,144.9
EBITDA (US$ m)	3,270.0	3,191.8	3,174.5	3,171.0
OCFPS (US$)	8.09	7.47	8.02	8.55
P/OCF (x)	3.0	2.4	2.3	2.1
EV/EBITDA (current)	1.9	1.9	1.9	1.9
Net debt (US$ m)	1,875	964	214	-543
ROIC (%)	24.82	21.63	20.88	20.15

Number of shares (m)	339.90	IC (current, US$ m)	6,125.00
BV/share (Next Qtr., US$)	—	EV/IC (x)	—
Net debt (Next Qtr., US$ m)	—	Dividend (Next Qtr., US$)	—
Net debt/tot cap (Next Qtr., %)	—	Dividend yield (%)	—

Source: Company data, Credit Suisse estimates.

- Third, BBY has much stronger internet leadership under Stephen Gillett's stewardship. Fourth, BBY is rolling its commission structure to appliances and hopefully to other parts of the store. Fifth, interim management seems more focused on shrinking the store base and improving service levels in the store.
- Finally, and very importantly, other Internet players, including Google, are looking for ways to partner with brick and mortar retailers to move more product search clicks through Google as opposed to Amazon. Given the tax situation equalizing in 2013, price match efforts and hopefully an improved site, BBY could be in an ideal position to use its stores as an advantage in this arena.
- Why not change the rating? Quite frankly Management is in flux, with articles about the old Chairman possibly coming in, the interim CEO making it quite clear that he would like to be considered for the top position, and a search committee out looking for the best candidate. We are concerned that in the interim, the chain may lose even more focus, hurting near term results until more permanent leadership is in place. While one can argue it would be hard for the stock to decline from here, weak results could do just that if the near term remains rocky.

Companies Mentioned *(Price as of 30 Jul 12)*
Amazon.com Inc. (AMZN, $236.09, OUTPERFORM, TP $270.00)
Best Buy (BBY, $18.06, NEUTRAL, TP $20.00)
Google, Inc. (GOOG, $632.30, OUTPERFORM, TP $770.00)

Disclosure Appendix

Important Global Disclosures

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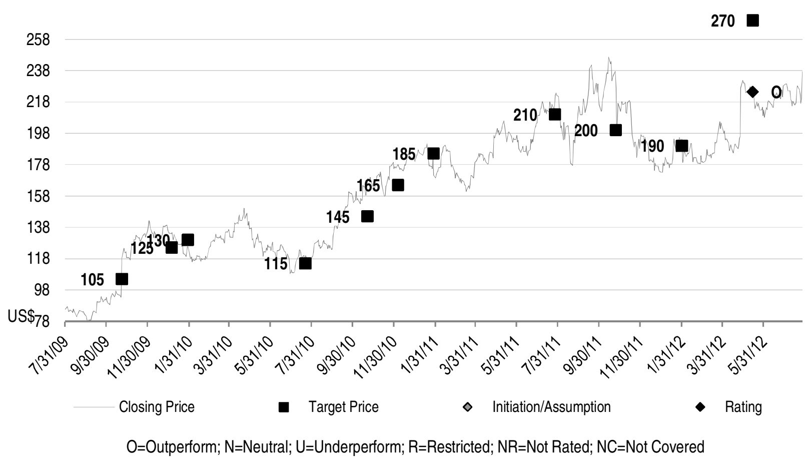
See the Companies Mentioned section for full company names.

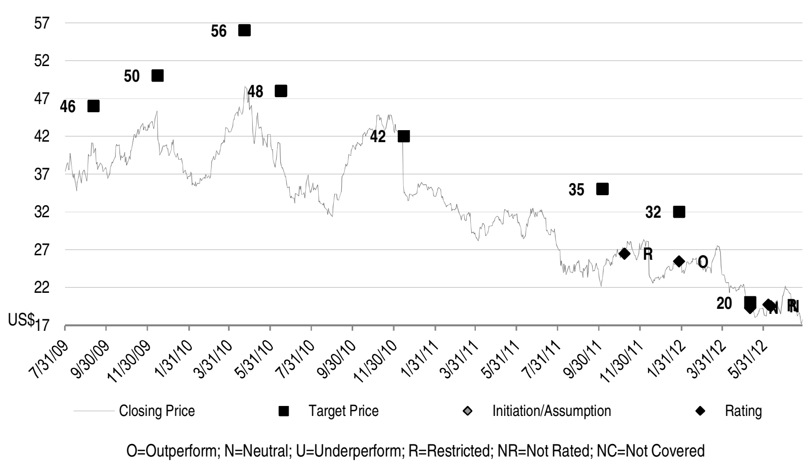
3-Year Price, Target Price and Rating Change History Chart for AMZN

AMZN Date	Closing Price (US$)	Target Price (US$)	Rating	Initiation/ Assumption
10/23/09	118.49	105		
1/5/10	134.69	125		
1/29/10	125.41	130		
7/22/10	120.07	115		
10/22/10	169.13	145		
12/6/10	178.05	165		
1/28/11	171.14	185		
7/27/11	222.36	210		
10/25/11	227.15	200		
1/31/12	194.44	190		
5/15/12	224.39	270	O	



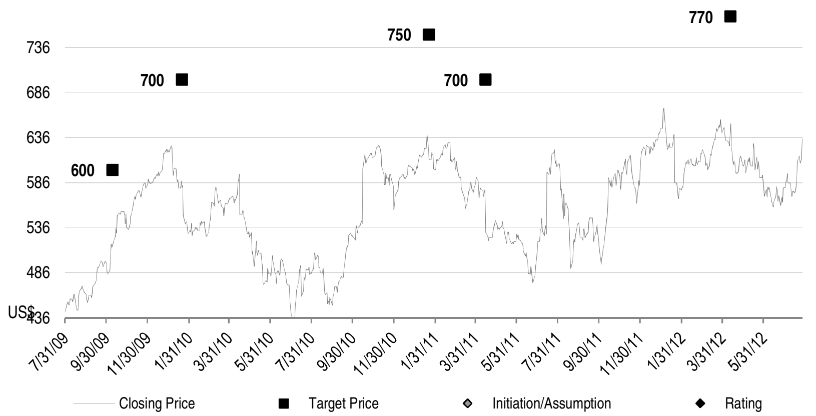
3-Year Price, Target Price and Rating Change History Chart for BBY

BBY Date	Closing Price (US$)	Target Price (US$)	Rating	Initiation/ Assumption
9/11/09	39.76	46		
12/15/09	41.53	50		
4/23/10	48.58	56		
6/16/10	38.18	48		
12/15/10	34.5	42		
10/5/11	23.16	35		
11/7/11	26.46		R	
1/27/12	25.44	32	O	
5/11/12	19.28	20	N	
6/7/12	19.7		R	
6/11/12	19.5		N	



3-Year Price, Target Price and Rating Change History Chart for GOOG

GOOG Date	Closing Price (US$)	Target Price (US$)	Rating	Initiation/ Assumption
10/9/09	516.25	600		
1/20/10	580.41	700		
1/21/11	611.83	750		
4/15/11	530.7	700		
4/12/12	651.01	770		



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

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Restricted	2%	

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Price Target: (12 months) for (AMZN)

Method: We use the discounted cash flow (DCF) method to calculate our $270 target price for AMZN. Our 5-year DCF uses a 3% terminal growth rate and a market-implied discount rate derived by discounting our unlevered FCF (free cash flow) estimates from 2013 through 2017 to arrive at the stock's current trading price. We then applied this discount rate to our 2013-2017 unlevered free cash flow estimates for AMZN.

Risks: Risks to our $270 target price for AMZN are a deteriorating global economy, competition from major offline retailers, volatility in operating margins, and unpredictable investment spending.

Price Target: (12 months) for (BBY)

Method: Our target price for BBY of $20 reflects 5.5x our 2012 EPS estimate of $3.65. We believe that the discount to other large cap discretionary retailers is warranted given the recent executive turnover at BBY, ongoing weak demand in the consumer electronics category, and fewer strategic initiatives to drive growth in the business.

Risks: Investing in hardlines retail stocks entails certain risks: changes in consumer spending and its components, retail industry competition, and general market risk. Other risks to BBY and our $20 price target are increased competition from the discount store segment and increased reliance on overseas economies for the supply of its product.

Price Target: (12 months) for (GOOG)

Method: We use the discounted cash flow (DCF) method to calculate our $770 target price for GOOG. Our five-year DCF uses a 3% terminal growth rate and a market-implied discount rate derived by discounting our unlevered FCF (free cash flow) estimates from 2008 through 2016 to arrive at the stock's current trading price. We then applied this discount rate to our 2011-2016 unlevered free cash flow estimates for GOOG.

Risks: Risks to our $770 target price for GOOG are a deteriorating global economy, lower than expected penetration in mobile, volatility in operating margins, and unpredictable investment spending.

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