

		From balance sheet	Better	111101
1 Net Income		1,277	1,277	
Depreciation		896	896	
Stock option expenses	SSE		121	Diff
Restructuring charges			198	Diff
Decrease in	Receivables	(328)	(328)	
	Merchandise inventories	(411)	(411)	
	Other current assets	41	41	
Increase in	Accounts payable	(382)	(382)	
	Unredeemed gift card liabilities	11	11	
	Accrued compensation and related expenses	26	26	
	Accrued liabilities	(210)	(210)	
	Accrued income taxes	(60)	(60)	
	Long-Term Liabilities	(73)	(73)	
Other Comprehensive income		133		Diff
Cash Flow fom Operations		920	1,106	Diff
Foreign currency translation adjustments		76		
Cash flow hedging instruments – unrealized gain (loss)		(1)		
Unrealized gains on available-for-sale investments		58	133	Diff
Short-term investments		68	68	
Property and Equipment		(452)	(452)	
PPE Sold = Depreciation - Increase in accumulated depreciation = 896 - 699		(197)	(197)	
PPE written down in Restructuring charges			(198)	Diff
Goodwill		(2)	(2)	
Tradenames, Net		26	26	
Customer Relationships, Net		76	76	
Equity and Other Investments		(4)	(4)	
Other Assets		17	17	
Cash Flow fom Investing		(468)	(533)	Diff
Short-term debt		(106)	(106)	
Current portion of long-term debt		406	406	
Long-Term Debt		(393)	(393)	
Noncontrolling interests		46	46	
Dividends (from Statement od Changes in Shareholders equity)		(238)	(238)	
Repurchase of common stock in Retained Earnings		(464)		Diff
Best Buy Co., Inc. Shareholders' Equity		(3)		Diff
Additional paid-in capital		(423)		Diff
Stock oprions (total)	SSE		182	Diff
Repurchase of common stock: APIC	SSE	(726)		
	Retained Earnings	(464)		
	Common stock	(3)	(1,193)	Diff
Cash Flow fom Financing		(1,175)	(1,296)	Diff
Change in Cash and cash equivalents		(723)	(723)	(723)

2 Average Debt - to - equity ratio for year ending February 26, 2011.

111101

		Feb 26, 11	Feb 27, 10	Average
Short-term debt		557	663	610
Current portion of long-term debt		441	35	238
Long-Term Debt		711	1,104	908
Total debt	a	1,709	1,802	1,756
Total Best Buy Co., Inc. shareholders' equity	b	6,602	6,320	6,461
Debt - to - equity ratio	a ÷ b	0.2589		0.2717
Total capital	a + b	8,311	8,122	8,216.5
Total Assets	c	17,849	18,302	18,075.5
Operating Liabilities	c-(a + b)	9,538.0	10,180.0	9,859.0

Times Interest Earned (for year ending February 26, 2011)

Tax rate = 714.0 ÷ 2,078.0 = 34.36%

Net earnings attributable to Best Buy Co., Inc.	1,277	
Interest expense	87	
Income tax expense	714	
	2,078	Middle
Equity in income of affiliates	2	
Net earnings attributable to noncontrolling interests	(89)	
	2,165	Worst

In the income statement, two items, Equity in income of affiliates and Net earnings attributable to noncontrolling interests are added after tax. So we have to add the tax to get the proper EBIT					Equ
Tax on Equity in income of affiliates	2 ÷ 65.64% • 34.36%	1			
Tax on Net earnings attributable to noncontrolling	(89) ÷ 65.64% • 34.36%	(47)			
Earnings before Interest and Taxes		2,032			Best

Interest expense	87.0
Capitalized interest	12.0
Interest expense (gross)	99.0

Times Interest Earned	Best	2,032 ÷ 99.0	=	20.5299
	Middle	2,078 ÷ 99.0	=	20.9899
	Worst	2,165 ÷ 99.0	=	21.8687

c ROA

$$\begin{aligned} &\text{Net Income} + (1 - \text{tax rate}) \cdot \text{Interest expense (gross)} \\ &\qquad\qquad\qquad 1,277.0 + 87.0 \cdot 0.6564 = 1,334 \\ &\text{EBIT (1-tax)} \qquad\qquad\qquad 2,032.5 \cdot 0.6564 = 1,334 \\ &\text{ROA} = \text{EBIT (1-tax)} \div \text{Average Assets} \qquad\qquad 1,334 \div 18,076 = \boxed{7.38\%} \end{aligned}$$

d ROTC

$$= \text{EBIT (1-tax)} \div \text{Average total capital} \qquad 1334 \div 8216.5 \qquad \boxed{16.24\%}$$

e ROE

$$\text{Net Income} \div \text{Average equity} \qquad 1,277 \div 6,461 = \boxed{19.76\%}$$

f ATO

$$\text{Asset turnover} = \text{Revenue} / \text{Average Assets} \qquad 50,272 \div 18,076 = \boxed{2.7812}$$

g MBIT

$$= \text{EBIT (1-tax)} / \text{Revenue} \qquad 2,032 \div 50,272 = \boxed{4.04\%}$$

h ROA

$$= \text{MBIT} \cdot \text{ATO} \cdot (1 - \text{tax}) \qquad 4.04\% \cdot 2.7812 \cdot 0.6564 \qquad \boxed{7.38\%}$$

**i OLLev
ROTC**

$$\begin{aligned} &\text{Operating Liabilities Leverage} \qquad 9,859 \div 8,217 = 1.1999 \\ &= \text{ROA} + \text{OLLev} \times [\text{ROA} - \text{ROA}] \\ &7.38\% + 1.1999 \times [7.38\% - 7.38\%] = \boxed{16.24\%} \end{aligned}$$

j Interest rate

$$87 \cdot 1,755.5 = 4.96\%$$

$$\text{After tax cost of interest (ATI Rate)} \qquad 4.96\% \cdot 65.64\% = 3.25\%$$

ROE

$$\begin{aligned} &= \text{ROTC} + \text{D/E} \times [\text{ROTC} - \text{ATI Rate}] \\ &16.24\% + 0.2717 \times [16.24\% - 0.0325] = \boxed{19.76\%} \end{aligned}$$

k Shares issued

392.5

Common stock in treasury

Shares outstanding

392.5

Book value per share as of Feb 26, 11.

$$\text{Total Best Buy Co., Inc. shareholders' equity} / \text{Shares outstanding} = 6,602.0 \div 392.5 = \boxed{16.82}$$

Question 3

a What is interest rate implicit in the capital leases of BB as of Feb 26, 11?

Future Minimum Lease Payments 2012				18.00
Current portion				14.16
Interest				<u>3.84</u>
Interest rate = Interest ÷ Present value	3.84	÷	79	= 4.86%

b Income tax expense

Increase in	Net deferred tax assets	291 - 126		<u>165</u>
				879
Increase in	Accrued income taxes			<u>60</u>
Taxes paid				939

c Depreciation expense on Property and Equipment

Increase in deferred tax liability for Property & equipment	316.0	-	381.0	=	(65.0)
Tax Depreciation - Reported Depreciation	(65.0)	÷	34.36%	=	(189.2)
Tax Depreciation =	896.0	+	(189.2)	=	706.8

d What was the average much state income tax rate for Best Buy the year ending Feb 26, 11?

Taxes paid	42.0	÷	65.00%	=	64.6
State income tax rate	64.6	÷	1,629.0	=	3.97%

e Foreign operations at US rate

at US rates	35.00%	•	449.0	=	157.2
Saving from US levels					<u>50.0</u>
Foreign taxes					107.2
Foreign tax rate	107.2	÷	449.0	=	23.86%

f Unredeemed gift card liabilities

Breakage gain	474		463		11
Net gift cards sold					53
					64

Question 4

111101

a	Year	MLP	Factor at ÷ 4.00%	Present Value			
	2012	1,208	÷ 1.0400	1,161.5			
	2013	1,166	÷ 1.0816	1,078.0			
	2014	1,079	÷ 1.1249	959.2			
	2015	992	÷ 1.1699	848.0			
	2016	872	÷ 1.2167	716.7	sum	=	4,763.5
	After 5 years: annual MLP			2,930.0	÷ 6.0	=	488.3
	Annuity Factor at 0.04 for 6 years			5.242			
	5 year present value factor			0.822			
	Present value now			0.822	•	5.242	• 488.3
	Present value of minimum lease payments						2,104.1
	Lease payments in year ending					Feb 26, 11	6,867.5
	Future value					Feb 26, 11	1,159.0
	Present value of minimum lease payments					Feb 27, 10	8,026.5
				8,026.5	÷ 1.040	=	7,717.8

Entries

Feb 27, 10

Fixed assets	7,717.8		
Capital lease obligations - Short term			850.3
Capital lease obligations - Long term			6,867.5

Changes from operating lease treatment

Depreciation expense	7,717.8	÷ 8.0	=	964.7		
Accumulated depreciation						964.7

Interest expense	4.00%	• 7,717.8	=	308.7		
Capital lease obligations - Short term				850.3		
Rental Expense						1,159.0

Capital lease obligations - Long term						
	1,208.0	-	4.00%	•	=	1,208.0
Capital lease obligations - Short term						1,208.0

Income Statement

Year ended Feb 26, 11

Earnings before interest and taxes more by	1,159.0	- 964.7	=	194.3
Interest expense more by				308.7
Earnings before taxes more by				(114.4)
Income tax expense	114.4	• 34.36%		39.3
Net Income more by	114.4	• 65.64%		(75.1)

Balance sheet

Feb 26, 11

Fixed assets	7,717.8
Accumulated depreciation	964.7
Net	6,753.1
Deferred tax Asset	39.3
Total	6,792.4

Capital lease obligations - Short term	1,208.0
Capital lease obligations - Long term	5,659.5
Retained Earnings	(75.1)
	6,792.4

b. Debt - to - Equity

Feb 26, 11

Total debt as reported	1,709.0	1,709.0 ÷ 6,602.0 =	0.2589
Capitalized Operating leases	6,867.5		as reported
Adjusted debt	8,576.5		
Equity as reported	6,602.0	8,576.5 ÷ 6,602.0 =	1.2991
Adjustment	(75.1)		adjusted
Adjusted equity	6,526.9	8,576.5 ÷ 6,526.9 =	1.3140

c. Times Interest Earned.

Year ended Feb 26, 11

	EBIT		Int Expen		Times Interest Earned.
As reported	2,032.5	÷	99.0		20.5299 as reported
Adjustment	194.3		308.7		
Adjusted	2,226.7	÷	407.7		5.4615 adjusted

a What was the market to book ratio as of March 1, 2011?

Stock price on March 1, 2011	\$ 32.00	from chart	
Book value per share as of Feb 26, 11.	\$ 16.82	from Q 2 of Best buy case	
Market to book ratio	$32 \div 16.82 =$		1.9025

b Are there any arguments given in the article as to why an investor would like to see off-balance sheet items on the financial statements?

In the second page of the article, at the top

Executives earlier this year set plans to cut the company's big-box square footage by 10% over the next five years as leases expire, but company critics want the retailer to close underperforming stores faster.

Leases

The leases are a constraint to the firm's operations. They can not get out the leases of, and close underperforming stores faster. If the leases were on the balance sheets investors would have seen clearly.

c Who will have higher ROA – Amazon or Best Buy? Why?

Amazon. Bestbuy will have lot more brick and mortar stores and inventories

Amazon

Can you guess who will higher ROE? If not, why?

No. It depends on debt to equity ratio of each company..

d What fraction of the annual EPS is from the fiscal second quarter, ended Aug. 27? Is it more than 1/4? If not why? Explain with figures in the article.

Actual EPS of last four quarters:

Q3, 2010	Q4, 2010	Q1, 2011	Q2, 2011
10-Nov	11-Feb	11-May	11-Aug
0.54	1.98	0.35	0.47

Rolling Four quarter EPS

Sum > 3.34

Fraction of the annual EPS from the fiscal second quarter

$$0.47 \div 3.34 =$$

0.1407

It is far less than 0.25 as the fourth quarter includes the holiday season

$$\text{Holiday Season share } 1.98 \div 3.34 = 0.5928$$

e How is BB boosting EPS? Do you approve of what they are doing?

The first article says

Though the company actually raised its per-share earnings outlook to a range of \$3.35 to \$3.65, up from \$3.30 to \$3.55, it was now factoring in the expected benefits of buying back \$1.5 billion in stock to reduce shares outstanding.

The second article says

... sufficient to support buybacks under Best Buy's new, \$5 billion share-repurchase program.

Buyback

BB is boosting EPS by buying back its shares not by increased net income. This is not sustainable.

f Compute the P/E (price to earnings ratio) of BB on Sept 1, 2011? How does it compare with other firms in the industry? What causes the differences?

Price Earnings Ratio

Price on Sept 1, 2011 ÷ Rolling Four quarter EPS from chart in article

$$23.34 \div 3.34 =$$

6.9880

The analyst estimate section has the P/E ratio as 7.24. This is much less than the industry average of 11.56. This is NOT because BB has low earnings. In fact the current earnings are higher. It is the future earnings that the market thinks will be lower. This can be seen from the next five-year forecast given by the analysts. For BB it is 9.13% compared to 14.60% for the industry.

g What is the total stock return percentage from Jan 1, 2011 to Sep 14, 2011?

Annual dividends		=	238
Number of shares	Net Income ÷ Earnings per share = 1277 ÷ 3.08	=	415.00
Annual dividends per share	Annual dividends ÷ Number of shares = 238 ÷ 415	=	0.57
Dividends for six months	0.57 • 0.5	=	0.29

Stock price on 1/1/2011	\$ 34.29	
Stock price on 9/14/2011	\$ 23.35	
Dividends for six months	\$ 0.29	
Dividends plus final value	\$ 23.64	
Stock return	(23.635 ÷ 34.29) -1	

(31.07)%