Bed Bath & Beyond Store Closures:

An Analysis Using a Capital Budgeting Framework

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Executive Summary and Introduction

Bed Bath & Beyond (BBBY), once a dominant player in the home goods retail industry, has faced significant financial and operational challenges in recent years. The rise of e-commerce, shifting consumer behaviors, and increased competition from retailers such as Amazon and Target have contributed to declining revenues and profitability. In response, BBBY announced widespread store closures as part of a restructuring strategy aimed at reducing costs and improving financial stability.

This paper examines this store closure decision by applying capital budgeting and financial statement analysis frameworks. The study assesses whether the company's strategic move to shut down operations was the correct decision in the long run. By analyzing Net Present Value (NPV), the report determines the financial viability of continued business activities versus liquidating assets. A sensitivity analysis is also conducted to evaluate the impact of various discount rates on BBBY's net operating cash flows. Findings indicate that declining sales and changing consumer preferences have significantly hurt BBBY's profitability, indicating that closing the store was ideal for profit maximization, but even then, profits were negative.

The purpose of this report is to critically assess the financial rationale behind BBBY's store closure decision by first analyzing BBBY's financial performance and market challenges throughout the years. Secondly, using Capital Asset Pricing Model (CAPM), Weighted Average Cost of Capital (WACC), NPV comparisons, and sensitivity analysis, the paper evaluates whether closing physical stores was the optimal strategic move.

Background and Context

BBBY was founded as “Bed n’ Bath” in 1971 by Leonard Feinstein and Warren Eisenberg. It started as a superstore specializing in bed linens and bath accessories, opening a store in New York and another one in New Jersey (SEC, 2002). In 1985, they rebranded to "Bed Bath and Beyond" since they wanted their name to reflect the expansion of their product line to domestic products and home furniture at competitive prices. They set themselves apart from competitors with their marketing strategy. They offer high-quality customer service and offer 20% coupons to customers, leading to an increase in foot traffic and customers' loyalty, thus increasing sales (Canvas Business Model, 2024). Moreover, according to Hunt (2023), the company experienced successful growth at their early stage, reaching $134M in revenue and $10.4M in profits in 1991.

In the 1990s, BBBY started to experience increased competition from Target, Luxury Linens, and, the main rival, Linens `n Things (Hunt, 2023). Selyukh (2023) and Basiouny (2023) concur that most competitors, such as Amazon and Linens 'n Things, started exploring and providing online shopping experience to their customers, but BBBY focussed on physical expansion with over 1,500 stores across different locations by 2018, hence joining late to the online platforms.

BBBY underwent an organization restructure where the board of directors changed CEOs, and their operations changed from a decentralized to a centralized purchasing and distribution model where all the purchasing and distribution decisions are made at the corporate level. The company started to experience their first negative net cash flows in 2019, to which Royan Cohen decided to force the replacement of Steven Tamares, CEO at the time for 16 years, with Mark Tritton, former CEO of Target (Hunt, 2023). Tritton was well-viewed since he implemented a successful strategy at Target that led to an increase in sales, hence, the BBBY board of directors believed bringing him as the CEO of the company, he would be able to replicate the success he had with Target (Basiouny, 2023). This was one of the main management mistakes the company made.

Hunt (2023) points out how the company was hiring “professional CEOs”, CEOs from the competition, to implement rivals strategies but they did not adjust them to the BBBY model, and did not listen to employees nor customers. Under Tritton’s management, revenue decreased by 33% (Hunt, 2023), as he attempted to sell private-label brands as opposed to national brands, mimicking the strategy employed at Target, which decreased the need to distribute coupons (Basiouny, 2023). Customers did not take lightly to these changes, leading to a decrease in customers’ trust in the company, resulting in lower foot traffic, and thus sales (Basiouny, 2023), which decreased by 30% from 2015 to 2021 according to Alda (2022, as cited in Hunt, 2023). Additionally, many of the rivals such as Target, Amazon, Walmart, and Wayfair gained 1% market share while they lost 4% within 4 years, from 2019 to 2023 (Atuan, 2024, as cited in Hunt, 2023).

Another management mistake was the acquiring of approximately six other brands in order to expand their product line. This, however, increased the pressure in inventory managing, marketing, and pricing operations. Cohen (2023) and Hunt (2023) agree that at the beginning of 2022, BBBY’s default on their credit loans led to the closure of their loan accounts, leading them to arrange a deal with a hedge fund to raise $225M or more in the following 10 months. This deal was canceled as they were not able to meet expectations. At the end of the second quarter of 2022, shareholders were expecting positive results from the optimization of inventory and changes in merchandise assortment, but got surprised with a drop in net sales, gross margin, and revenues of 28%, 18.5%, and $256M, respectively. Cohen (2023) reports that BBBY estimated a decrease of 20% in sales for the entire year, but in a quarter, sales fell 25% from the previous year. They have been experiencing decreasing net earning from 2014 to 2022 and by May 2022 the financial report estimated that the company was $217M short in expenses (Hunt, 2023). According to Basiouny (2023), BBBY have been repurchasing $11.8 billion worth of shares back since 2004 to make their $5.2B debt less important. They started borrowing to keep repurchasing their shares until the 2022 holiday season (Cohen, 2023).

Last quarter of 2022, BBBY had total debt of $5.2B, exceeding assets by $800M, and owing to 25,000 to 50,000 creditors (Cohen, 2023). After a long time being in financial distress and trying to alleviate it, BBBY filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of New Jersey in April 2023. This caused loss of many jobs due to store closures and supply chain issues due to delayed payments and credit default. After, they started liquidating their assets and closing stores around different locations (SEC, 2023). In June 2023, BBBY, including its intellectual property, trademarks, and other assets, was sold for $21.5M to Overstock.com ("Bed Bath & Beyond - WikiMili, the Best Wikipedia Reader," n.d., as cited in Hunt, 2023).

Data and Methodology

The data being used in this analysis is pulled from the end-of-year annual report, FORM 10-K, that all American firms must publish at the end of their fiscal year. The decision by BBBY for bankruptcy will be analyzed using a comparative analysis of the NPV of predicted future cash flows versus the NPV of liquidation of the firm's assets. These two NPVs will set the decision rule for their liquidation decision, and we will be able to observe whether the actual decision taken was consistent with this criteria. Sensitivity analysis will also be employed, as it gives an idea on whether any marginal changes in the discount rate at the time of the firm's bankruptcy would have changed the decision taken.

The main tools used in this analysis are the CAPM, NPV, and sensitivity analysis. The core of the capital budgeting framework that this paper is based on is NPV analysis, which is based on the idea that a firm should not invest in a project unless its NPV is positive, meaning that it will increase the firm's value in the long run. NPV analysis is relevant to BBBY's bankruptcy decision as the decision to continue operations can be perceived as an investment into their future, meaning they should continue their operations only if the NPV is positive. Nonetheless, in order to proceed with the NPV calculations, we need a discount rate. In this paper, we will use the WACC to discount the future cash flows, however, we need to estimate the cost of equity for which the CAPM will be a useful tool to derive it. Moreover, sensitivity analysis is a useful tool to estimate the elasticity or how sensitive the NPV is when revenue, costs, etc. changes. In this situation the cash inflows of the company are uncertain, so adjusting some of the decision factors such as the discount rate, in this case the WACC, will prevent the over reliance on any metrics and will help us understand whether the decision taken by the firm is consistent in multiple scenarios.

As mentioned earlier, the data used in this report comes from BBBY's FORM 10-K for the fiscal year ending on February 25, 2023, as this was their last full fiscal year of operations. This report contains many financial statements outlining BBBY's assets, liabilities, and cash flows. The statements that will be emphasized are: the Consolidated Balance Sheets as of February 25, 2023 and February 26, 2022, Consolidated Statements of Operations, Consolidated Statements of Shareholders' (Deficit) Equity, and Consolidated Statements of Cash Flows, with the last three statements containing data from fiscals 2020-2021, 2021-2022, and 2022-2023. These balance sheets will provide an insight into the financial position the company was in during its last operation years in physical locations.

Analysis and Discussion

To understand whether the decision that BBBY took to close its operations was correct, we estimated the potential value of the firm if they would have continued operations under two scenarios. In the first scenario, they experience 10% growth in cash flows per annum, $NPV_{cont,i}$, for the next six years, while in the other one, they experience 10% decreases in cash flows per annum, $NPV_{cont,d}$. Both of these NPVs will then be compared to the value of closing operations, liquidating their assets, NPV_{liq}, offering insight into whether BBBY made the right decision.

The following metrics come from FORM 10-K (2023), with the net operating cash flows representing the expected future cash flows from continued operations:

Net Operating Cash Flows	-$990,979,000
Total Assets	$2,225,217,000
Total Liabilities	$5,025,225,000
Long-Term Debt	$1,026,133,000
Net Interest Expenses	$110,497,000
Borrowings of Debt	1,590,000,000

As mentioned in the previous section, the r_{WACC} is used as the discount rate to compute these NPVs. The r_{WACC} represents the weighted required rate of return the firm has to pay their debtholders and shareholders to justify their investments. Based on our discussion of BBBY's background, they were in a state of financial distress for a while, making their cost of capital very high. A continuous decrease in the valuation of the firm led to the investors getting worried about the company's performance, meaning that for investment to continue, investors have a higher required rate of return on their investments in the form of either recovery in the company's stock price or the distribution of dividends. The debt cost incurred by BBBY also increased over this period as they had been defaulting on some of their loans, which led to a break in the trust between the firm and their debtholders (Cohen, 2023; Hunt, 2023).

The r_{WACC} used in this analysis is an estimate based on their last operating year (fiscal 2022-2023). According to FORM-10 K (2023), BBBY had an average of 83,342 nine-months-ended outstanding shares, and we used the share price of \$1.53 (Investing, n.d.) from the closest date, February 25, 2023, to when the report was released. This means that around this time, the stock market value of BBBY was \$127,513.26 (1.53*83,342). Using the firm's long-term debt amount of \$1,026,133,000, with a tax rate of 0.9%, the after-tax value of the firm was \$1,017,025,316 (\$1,026,133,000(1-0.009) + \$127,513.26) (SEC, 2023).

To estimate the cost of capital that the firm faces, we will use the CAPM. Using the risk free rate (r_f) of 3.95% provided by Federal Reserve Economic Data on February 24, 2023, the closest date to the one that the report was released on (February 25, 2023). Yahoo Finance reports the Beta (5Y Monthly) of 1.87 > 1 which indicates that the BBBY stock had greater volatility than the market (S&P 500) (Yahoo Finance, n.d.). The S&P 500 index return rate is used as the market returns, which was 26.29% in 2023. Thus, the cost of equity can be estimated by: $r_S = r_f + \beta(r_m - r_f) = 0.0395 + 1.87(0.2629 - 0.0395) = 0.457$.

For the cost of debt, we'll use net interest expenses of \$110,497,000 and the borrowings of debt being used of \$1,590,000,000 (SEC, 2023). Thus the cost of debt $r_B = \frac{\$110,497,000}{\$1,590,000,000} = 0.069$. The $r_{WACC} = \frac{\$127,513.26}{\$1,017,025,316}(0.457) + \frac{\$1,026,133,000(1-0.009)}{\$1,017,025,316}(0.069)(1-0.009) = 0.06842$, thus the discount rate that is used in the NPV calculation of the 2 scenarios will be 6.84%.

$$NPV_{cont,i} = -\ \$990,979,000 - \frac{\$990,979,000(0.9)}{(1.068427724)} - \frac{\$990,979,000(0.9)^2}{(1.068427724)^2} - \frac{\$990,979,000(0.9)^3}{(1.068427724)^3} - \frac{\$990,979,000(0.9)^4}{(1.068427724)^4} - \frac{\$990,979,000(0.9)^5}{(1.068427724)^5} - \frac{\$990,979,000(0.9)^6}{(1.068427724)^6} = -\$4,394,503,153.58$$

$$NPV_{cont,d} = -\ \$990{,}979{,}000 - \frac{\$990{,}979{,}000(1.1)}{(1.068427724)} - \frac{\$990{,}979{,}000(1.1)^2}{(1.068427724)^2} - \frac{\$990{,}979{,}000(1.1)^3}{(1.068427724)^3}$$

$$- \frac{\$990{,}979{,}000(1.1)^4}{(1.068427724)^4} - \frac{\$990{,}979{,}000(1.1)^5}{(1.068427724)^5} - \frac{\$990{,}979{,}000(1.1)^6}{(1.068427724)^6} = -\$7{,}583{,}007{,}479.05$$

Now that we have calculated the two NPVs from continued operations, we need to calculate the NPV of liquidation.

$$NPV_{liq} = \text{Total Assets - Total Liabilities} = \$2{,}225{,}217{,}000 - \$5{,}025{,}225{,}000$$

$$= -\$2{,}800{,}008{,}000$$

In both scenarios, the NPV of continued operations is less than the NPV of liquidation, so based on this criteria, BBBY made the correct decision.

Moving on to the sensitivity analysis where we will vary the WACC from 5% to 15% to see how much this would affect the results gotten above. In the table below, it shows the changes of $NPV_{cont,i}$ and $NPV_{cont,d}$, following the formula above, when just the denominator changes to $(1 + WACC_i)^t$:

WACC	**$NPV_{cont,i}$**	**$NPV_{cont,d}$**
5%	-$4,578,900,978.78	-$8,010,335,039.18
6%	-$4,476,868,772.78	-$7,773,453,822.46
7%	-$4,379,489,339.34	-$7,548,369,162.23
8%	-$4,286,489,689.84	-$7,334,350,919.43
9%	-$4,197,615,896.62	-$7,130,721,795.32
10%	-$4,112,631,570.06	-$6,936,853,000.00
11%	-$4,031,316,471.59	-$6,752,160,315.08
12%	-$3,953,465,249.42	-$6,576,100,511.40
13%	-$3,878,886,284.84	-$6,408,168,086.61
14%	-$3,807,400,638.67	-$6,247,892,291.43
15%	-$3,738,841,088.12	-$6,094,834,416.47

Thus, even with a 15% WACC, the optimal decision would still be to liquidate the firm.

For the firm to even consider continuing operations under the worse case scenario, 10% cash flows decline per annum, they would need a minimum of around r_{WACC} 65%, which is not a rational since the WACC is directly and significantly affected by the costs of equity(r_s) and/or the cost of debt (r_B). This implies that either one of them, or both, should increase substantially to obtain this level of r_{WACC}, and since the firm is already in financial distress, it would not make sense for them to desire a higher cost of capital. Thus, we can say that based on these two forms of analysis, BBBY's decision to close its operations was the optimal decision to make.

Implications and Conclusions

A main driver of the Bed Bath and Beyond bankruptcy was the poor management of the executives of the firm. As mentioned before, the firm underwent a change in management where they hired the previous Target CEO, Mark Tritton, as he was the driving force behind Target's improved performance at the time. Replicating Target's business strategy did not work with BBBY since the main business drivers, customers and employees, were not taken into account. This means that the BBBY ignored what their customers were looking for and attempted to replicate the success of another store with a very different clientele and business model. The disparity between the strategies that worked for Target and what works for BBBY, coupled with the complete shift to Target's model cost the firm a lot of potential revenue and loss of sales. This can serve as a lesson for other firms in similar positions to BBBY, that simply because a business model and strategy works for one company does not mean that it is universally applicable.

The analysis from the previous section shows how the firm made the right decision of shutting down, as even if they experienced an improvement of 10% every year, their net operational cash flows would still be negative, no matter if the r_{WACC} was as low as 5% or as high as 15%, and that they should only consider continuing operations with a minimum r_{WACC} of 65% in the 10% decline per annum scenario. The results show that liquidating their remaining assets and using the proceeds to pay debt holders results in less losses than continuing to operate. Therefore, based on our analysis, if we were financial analysts presented with the data from this paper, we would have also advised the firm to cease operations.

This report makes use of different financial analysis tools such as sensitivity and NPV analysis, CAPM, and the computation of the WACC to analyze the decision of the company to shut down operations. This study can be extended to other firms also experiencing or on the verge of experiencing financial distress to either minimize their negative cash flows, or prevent it altogether. Additionally, there exist other models and tools that could also be used to provide another perspective of this analysis. An extension of this topic can take place by using the adjusted present value calculation, which uses the usual NPV calculation but it also considers the financing effects, which can increase or decrease the value of a project, in this case continuing operations, depending on the effect. For example, if the firm was considering expanding the company to locations where there was high demand for the products provided, the firm could have reduced their negative cash flows, broken-even, or even come back to net positive profits.

To extend this analysis further, other studies can analyze how options may have helped the company prevent the sustained losses in revenue, or even get out of financial distress. For example, the assets of the firm could be the underlying asset of the option contract and the amount owed to debt holders could be the exercise price. Other authors could analyze the benefits of using put and calls in their situation and which one, or combination of both, would have had a better impact on BBBY's financial cash flows.

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