

BARNES & NOBLE INC BKS

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by

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			2015	2016
Price:	25.00	EPS	0	0
Shares Out. (in M):	75	P/E	0	0
Market Cap (in \$M):	1,870	P/FCF	10	9
Net Debt (in \$M):	-220	EBIT	0	0
TEV (\$):	1,650	TEV/EBIT	0	0

Description

Barnes & Noble, Inc. (BKS)

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Summary

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Our fund generally focuses on smaller companies with “Ft. Knox” balance sheets and large and sustainable free cash flow yields. We are often seeking a mid-teens FCF yield or higher on an unleveraged basis. The objective is for the sustainable FCF to eventually drive up the share price to a more reasonable valuation through share buybacks, debt reductions, dividends, or accretive acquisitions. Obviously, it is important we have a management team that cares about shareholder value.

Barnes & Noble (BKS) is the dominant bookstore retailer in North America with a highly cash-generative business model, stable comp store sales in Retail segment, and growth opportunities in College segment. BKS trades at about 0.3x revenues, 4.5x adjusted EBITDA for FYE April 2015, and a 10% unleveraged free cash flow yield with an established market position in both its Retail and College segments. Importantly, BKS has a conservative balance sheet, with net cash of about \$300m expected at FYE April 2015. We expect BKS to further build its net cash position over the next couple of years. As net cash builds, we think it is very possible an aggressive share repurchase and/or dividend program to enhance shareholder value could be initiated.

MJS27 did an excellent write-up of BKS in February 2014 at about \$16 per share (versus \$25 per share today) but many positive events have occurred since then which we discuss below such that we think BKS is undervalued today. Also, BKS will report Q3 earnings on March 10th and, while we are hopeful for more progress, our time horizon for this investment is closer to two years.

BKS recently announced plans to spin off its College segment into a separate publicly traded company by August 2015 and filed an S-1 related to this transaction. Our analysis is on a consolidated basis for BKS three segments – Retail, College, and NOOK. While the spin-off might help improve the overall valuation, we believe the most important factor in driving consolidated shareholder value will be the adjusted EBITDA performance of the three segments in FY15 and FY16. This is where our analysis is focused.

We believe BKS gives investors an opportunity to participate in the strong cash flows of the dominant bookstore retailer in North America, with a well-entrenched market position, and one of the largest players in the college bookstore segment, which has good growth prospects. We believe BKS management will continue to move aggressively to right-size NOOK's cost structure and reduce the cash burn drag it currently places on the company. We expect investors to increasingly focus on the prodigious cash generation of Retail and College segments over the next couple of fiscal years as losses at NOOK are further reduced. We recognize Retail will never be a major growth business but we believe current prices undervalue its substantial cash generation capabilities.

We believe BKS can reduce NOOK's adjusted EBITDA losses to about \$50m in FYE April 2016 and generate consolidated adjusted EBITDA (including Retail, College, and NOOK) of about \$380m for FYE April 2016, with a net cash position of about \$500m at FYE April 2016. Based on 6.5x adjusted EBITDA of about \$380m plus about \$500m of net cash, we believe BKS could have a market value of about \$3b by FYE April 2016 or about \$40 per share, roughly 60% higher than today's share price of about \$25 per share.

Three Segments: Retail, College, and NOOK

BKS has three business segments including Retail (\$4.2b revenues and \$340m adjusted EBITDA); College (\$1.75b revenues and \$100m adjusted EBITDA); and NOOK (\$375m revenues and negative \$160m adjusted EBITDA).

Retail includes 658 bookstores, primarily under Barnes & Noble Booksellers trade name. These stores generally offer a dedicated NOOK area, a comprehensive trade book title base, a café, and departments dedicated to Juvenile, Toy & Games, DVDs, Music, Gift, Magazine and Bargain items. About 4% to 6% of Retail sales are from best-seller books. Retail segment also includes the company's ecommerce website, www.barnesandnoble.com and its publishing operation, Sterling Publishing. Retail was 67% of total sales in FY14 with \$4.3b in sales. Retail core comp store sales (ex-NOOK) were down 3% in FY14. Retail core comp stores sales improved to flat for 6mos of FY15 and were +1.7% for the holiday season of 2014.

College includes 714 stores that are primarily school owned stores operated under contracts by College and include sales of digital content within the higher education market through Yuzu. College contracts are typically for five to ten years, but many contracts have a 90 to 120 day cancellation right. College stores generally offer new, used, rental, and digital textbooks, course related materials, emblematic apparel and gifts, trade books, computer products, NOOK products, school and dorm supplies, and convenience and café items. College was 27% of total sales in FY14 with \$1.75b in sales. College comp store sales were down by 2.7% in FY14 and improved to down 0.2% for 6mos of FY15. College segment may offer growth opportunities as BKS notes that 55% of colleges still operate their own bookstores and College believes its out-sourcing alternative could be attractive to many

of these self-operated stores.

College is one of the three largest players in the college bookstore industry. College was acquired by BKS in 2009 from Leonard Riggio, BKS then-CEO, for about \$460m net of cash acquired. BKS issued two seller notes as part of the transaction, both of which have since been repaid.

NOOK is the company's digital business, including the development and support of the company's NOOK product offerings. The digital business includes digital content such as eBooks, digital newsstand, apps, and sales of NOOK devices and accessories through Retail, College, and third parties. NOOK was 5% of total sales in FY14 at \$423m in FY14 and NOOK sales were down 35% in FY14 and were down 48% for 6mos of FY15.

Segment EBITDA results are detailed below:

Segment EBITDA							6 mos.	6 mos.
FYE 4/30 (mm's)		FY10	FY11	FY12	FY13	FY14	FY14	FY15
B&N Retail		\$337	\$259	\$324	\$376	\$354	\$101	\$92
B&N College (a)		\$25	\$113	\$116	\$112	\$115	\$65	\$48
NOOK		(\$81)	(\$209)	(\$261)	(\$481)	(\$217)	(\$100)	(\$42)
Total		\$281	\$163	\$179	\$7	\$252	\$66	\$98

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- a. College was acquired in September 2009 for \$460m net of cash acquired.

Stable Retail and College Adjusted EBITDA

Key to our thesis is the stable adjusted EBITDA generated by the Retail and College segments over the last several years. Combined adjusted EBITDA for Retail and College has averaged close to \$450m per year for FYE April 2012, 2013, 2014, and (we project) 2015. This represents close to \$1.8b of cumulative adjusted EBITDA from Retail and College over the last four FY's, or about 120% of today's EV. We believe Retail and College's adjusted EBITDA will remain resilient over the next few FY's due to incremental growth strategies and tight expense controls.

We believe the market for e-Readers, including Kindle and NOOK, flattened in 2013 and 2014, after several years of rapid growth.

We believe these may be niche products and that physical books will show considerable resiliency. Retail and College comp store sales for year-to-date FYE April 2015 have been relatively stable. Retail core comp store sales (ex-NOOK) were +1.7% for the 2014 holiday season.

Given its stable history, we believe BKS could borrow almost 4x adjusted EBITDA or more, representing almost its entire EV. BKS has a \$1b credit facility in place which is unused. Our investments in situations where the company can borrow anywhere near the EV of the business have generally worked out quite well – this is not surprising given that credit markets are usually more conservative and disciplined than equity markets.

Over the past several years, BKS has invested adjusted EBITDA generated by Retail and College into its NOOK segment with poor results. Cumulative adjusted EBITDA losses at NOOK from FY11 to FY14 were about \$1b, or close to 65% of BKS current EV.

We believe Retail and College segment EBITDA for FYE April 2015 will be relatively flat with FY14 results (\$450m of combined EBITDA) and NOOK segment EBITDA will be about negative \$110m for about \$340m of consolidated EBITDA for FYE April 2015. We note that College will invest \$15m to \$20m in Yuzu, a new digital textbook product for students, in FYE April 2015.

Reduced NOOK Losses

BKS is aggressively downsizing its NOOK segment, moving to a more content-focused strategy. BKS outsourced the hardware side of NOOK via a deal with Samsung in June 2014 where Samsung's tablets combine with NOOK's customized software to offer customers a NOOK by Samsung solution. This has enabled BKS to reduce losses at NOOK and losses have been reduced by about 50% for six months of FYE April 2015, from \$100m in adjusted EBITDA losses for six months of FY14 to \$42m in adjusted EBITDA losses for six months of FY15. And this was before the Microsoft/Pearson Repurchase Transaction.

CEO Michael Huseby was asked on the Q2 FY15 conference call, "Does this transaction with Microsoft, I know it just closed, but did this give you flexibility for another round of cost-cutting at NOOK that you couldn't have done because of your obligations under the contract?". He responded, "Yes, we said that, I think we said that clearly." He continued later on: "So we have more operational flexibility which gives us a better opportunity to improve profitability at both NOOK digital and Retail..."

Huseby is an ex-CFO with Cablevision and has Liberty Media ties and actually ran the NOOK segment before his current role and we expect him to be very logical in right-sizing NOOK's cost structure to its current revenue potential (which seems to be declining rapidly).

Microsoft/Pearson Repurchase Strengthens Balance Sheet and Enables Further Rationalization

In December 2014, BKS repurchased the \$385m of preferred shares in NOOK Media owned by Microsoft and Pearson for about \$150m, consisting of \$75m in cash and 3.3m shares of common stock. This transaction substantially improved BKS balance sheet: (1) it eliminates the Preferred Membership Interests at NOOK Media; (2) it eliminates the put option overhang; (3) it eliminates about \$200m in commercial financing liabilities; and (4) it eliminates obligations for international development.

The Repurchase Transaction gives BKS increased ability to right-size NOOK's cost structure and enables further cost reductions. We expect NOOK's adjusted EBITDA losses to be reduced by about 50% in FYE April 2015 to about \$110m and further reduced to about \$50m in FYE April 2016. In the event BKS sells NOOK within three years, Microsoft and Pearson have the right to participate pro rata (about 28%) in the sale proceeds.

The Repurchase Transaction in December 2014 and the Samsung partnership in June 2014 reflect a more rational and conservative approach to NOOK with a focus on selling eBook content rather than hardware. NOOK sales currently represent a small portion of total BKS sales and do not justify the current expense structure.

Spin-off of College from Retail and NOOK

BKS recently announced it would spin-off its College segment from Retail and NOOK into a separate public company by August 2015, citing College's growth opportunities and unique positioning with college students. We believe this strategy makes some sense and that College could trade at a higher adjusted EBITDA multiple, given its superior growth opportunities.

We believe BKS will focus on improving sales trends in its Retail segment and reducing NOOK's cash burn towards break even.

BKS has stated there are continuing discussions with potential partners for the NOOK business, including the possibility of funding for the NOOK entity. However, given the weak sales results for NOOK to date, including the Samsung by NOOK devices, we are not ascribing any value to NOOK at this point.

Retail Has Solid 2014 Holiday Sales While NOOK Does Poorly

BKS reported sales results for the nine-week period ended January 3, 2015 and these were solid for Retail, with core comp store sales (excluding NOOK) up 1.7% compared to prior year. Based on these results, BKS updated its guidance for FYE April 2015 to flat core comp store sales for Retail. We believe this indicates continued stabilization of physical book sales and growth in educational toys and games and gifts.

Conversely, NOOK sales were poor with total sales of \$56m for the nine week period down 55% versus prior year. NOOK device sales were \$29m, down 68% versus prior year and digital content sales were \$27.4m, down 25% versus prior year.

Valuation

BKS has about 75m fully diluted shares outstanding. This assumes conversion of a convertible preferred of about \$195m convertible at \$17 per share and also about 3.3m shares issued to Microsoft and Pearson as part of the NOOK repurchase transaction completed in December 2014. BKS trades at about \$25 per share for a market cap of about \$1.87b fully diluted. We expect BKS to have a net cash position of about \$300m at FYE April 2015 for a total enterprise value (EV) of about \$1.57b. For FYE April 2015, we expect adjusted EBITDA of about \$340m (including EBITDA losses from NOOK of \$110m). We expect free cash flow (cash from operations less capital expenditures) of at least \$150m for FYE April 2015. BKS is trading at an unleveraged FCF yield of about 10% and an adjusted EBITDA multiple of about 4.5x on our FYE April 2015 estimate.

We believe BKS can reduce NOOK's adjusted EBITDA losses to about \$50m in FYE April 2016 and generate consolidated adjusted EBITDA (including Retail, College, and NOOK) of about \$380m for FYE April 2016, with a net cash position of about \$500m at FYE April 2016. Based on 6.5x adjusted EBITDA of about \$380m plus about \$500m of net cash, we believe BKS could have a market value of about \$3b by FYE April 2016 or about \$40 per share, roughly 60% higher than today's share price of about \$25 per share.

Management and Strategy

Michael Huseby became CEO of BKS in early 2014 after serving as CFO of BKS and CEO of the NOOK segment the prior couple of years. He was formerly CFO at Cablevision, a large cable TV operation. He has long-term ties to Liberty Media and we believe he is highly focused on profitability and free cash flow generation.

BKS's strategy has focused on: (1) growing revenues at Retail through new categories such as educational toys and games and new events to drive traffic into stores; (2) growing revenues at College through new contract acquisitions and new products and services oriented towards students and faculties; and (3) shifting NOOK towards a less costly and capital-intensive software-oriented strategy and continuing to rationalize NOOK's cost structure to better align it with the revenue base.

Competition; Retail vs. Online; eBooks vs. Physical books

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Competitive threats to BKS include: (1) increased online sales of books by Amazon and (2) increased sales of eBooks versus physical books. Both trends have had an impact on Retail sales over the past several years.

We believe in 2014 in the U.S. about half of physical book sales were in stores and half were purchased online. Bookstores have consolidated significantly over the past several years in the U.S. as online sales have taken a larger share of the market, most notably with the closing of Borders stores in 2011. Amazon's online business model has been operating for several years and while it will continue to pressure Retail results going forward, we think Retail's stable financial results over the past several years show that it can likely operate reasonably in an environment against Amazon. CEO Huseby has cited BKS "more personal relationship with customers" as a key differentiator versus Amazon. We believe there is a significant segment of the market that will continue to purchase books in stores.

With regard to eBooks, in 2013 and 2014, demand for e-Readers and eBooks has slowed down significantly, with market growth for 2013 and 2014 estimated to be flat. NOOK sales trends have been extremely poor. There have been some recent studies that indicate demand for physical books versus eBooks may be more resilient than previously expected. The jury is still out on this issue but we believe physical book demand may have more staying power than expected.

Major Shareholders

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BKS has some smart shareholders including Abrams Capital (6%) and Dan Tisch (8%). While this does not guarantee a successful investment, we are encouraged by their presence, although they are invested at lower prices.

Attractive Working Capital Model and Seasonality

BKS has an attractive working capital model. BKS' inventories are significantly offset by accounts payable (generally 65% to 70% of inventories). BKS vendors effectively finance most of the inventory investment, resulting in a higher ROIC, less capital-intensive business model.

BKS business is seasonal with disproportionate Retail revenues generated during the holiday season (FY Q3) and disproportionate College revenue generated during the back-to-school Rush period in September (FY Q2). Q3 is the strongest quarter for cash flow and adjusted EBITDA due to holiday sales in Retail segment. In Q4, payments are made to trade creditors and the net cash position declines modestly at FYE.

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Strong Cash Flow Generation and Solid Business Model

BKS has reasonable capital expenditure and working capital requirements. We expect BKS to achieve adjusted EBITDA of \$340m consolidated (including Retail, College, and NOOK) for FYE April 2015. We believe adjusted EBITDA could grow to \$380m in FYE April 2016. Capital expenditures over the past few years have averaged about \$150m per year. Working capital has remained fairly stable. Retail and College have achieved steady gross margins of about 30% and 25% respectively over the past several years.

From FY11 to FY14, cumulative adjusted EBITDA from the Retail and College segments was about \$1.8b or 120% of today's EV. BKS's business model, excluding NOOK, enables it to consistently generate cash. Even in FYE April 2010, in a very difficult economy, Retail generated almost \$340m of adjusted EBITDA. We believe it would not be unreasonable for this cash-generative business to trade at 6.5x adjusted EBITDA, assuming stable core retail sales.

Strong Balance Sheet and Expected Continued Build Up in Net Cash Position

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BKS has a strong balance sheet with a net cash position of about \$200m at FY15 Q2 ended November 2014. We expect the net cash position to build further to about \$300m at FYE April 2015 and further to \$500m at FYE April 2016.

BKS was able to generate solid cash flow even in the difficult economic conditions of 2009-10 and while absorbing NOOK losses. We expect net cash to build at close to \$200m per year over the next couple of years, and this could be conservative. We believe the continued build up in net cash will highlight BKS's attractive business model and could result in an improved valuation.

Solid ROIC Business Model

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BKS has a solid ROIC business model with reasonable capital expenditures and working capital investments. As discussed, vendor payables mostly offset the inventory investment. We calculate ROIC for BKS as adjusted EBITDA less capital expenditures divided by sum of the net working capital investment plus net book value of PPE. For BKS, this is about \$350m of adjusted EBITDA - \$150m of capital expenditures or about \$200m in the numerator, divided by net working capital of about \$350m plus \$350m net book value of PPE, for a total of \$700m in the denominator. $\$200m/\$700m$ is about a 40% ROIC.

FY15 Year to Date Retail and College Results Solid

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The Company's results for six months of FYE April 2015 were solid with Retail core comparable sales and College comp stores sales both positive for Q2. Total sales for six months of FY15 were \$2.9b versus \$3.1b in prior year. Consolidated EBITDA improved to \$97m versus \$67m in prior year, up 44% due primarily to reduced adjusted EBITDA losses at NOOK, which were negative \$42m in FY15 versus negative \$100m in FY14. Six months of FY15 adjusted EBITDA for Retail was \$92m versus \$101m in prior year, due primarily to expense deleverage on lower sales. Adjusted EBITDA for College was \$48m versus \$65m in prior year, due primarily to increased investments in Yuzu and other areas.

We believe the stability of 2014 can continue into 2015 and beyond, driven by stable revenues in Retail and growth in College. BKS should also benefit from well-controlled operating expenses and capital expenditures, and a favorable working capital model, all of which should support adjusted EBITDA and FCF over the next few years.

Excellent Potential for Share Repurchase or Dividends or Niche Acquisitions

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As BKS balance sheet gets stronger, we believe a major share repurchase program and/or dividend becomes a strong possibility. Strong cash generation and a conservative balance sheet provide multiple levers to drive shareholder value.

Pension Costs

BKS pension plan is fairly well-funded so pension expenses and cash contributions are not onerous going forward.

Conclusion and Target Price

Based on 6.5x our adjusted EBITDA of \$380m in FYE April 2016 and about \$500m in net cash at FYE April 2016, we believe BKS could trade for a market value of about \$3b or about \$40 per share versus \$25 per share today (+60%). We believe 6.5x adjusted EBITDA is possible if sales trends for Retail and College segments remain stable (flat to slightly positive comp store sales) with reduced NOOK losses. Further, we believe the solid market position of Retail and College's growth potential could prove attractive to a strategic or financial acquirer.

Major Shareholders	Shares	%
Leonard Riggio	12,000,000	20.0%
Daniel Tisch	5,030,000	8.4%
Dimensional Fund Advisors LP	4,900,000	8.19%
Abrams Capital Management L.P.	4,100,000	6.83%
Vanguard Group, Inc. (The)	3,874,954	6.39%
JP Morgan Chase & Company	2,734,627	4.54%
BlackRock Fund Advisors	2,372,814	3.94%
Cheapeake Partners Management Co Inc./Md	2,214,709	3.68%
Towerview LLC.	1,991,250	3.31%
Pine River Capital Management L.P.	1,875,000	3.11%
State Street Corporation	1,406,288	2.33%
Gendell, Jeffrey L.	1,314,403	2.18%

Price per share	\$25	
Shares out. (1)	75m fully diluted	
Market value	\$1.87b	
52 week range	\$15.38	\$26.22

1. Assumes conversion of \$195m of convertible preferred stock at \$17 per share.

Avg Daily Volume

690,000

Income statements			3mos						6mos	6mos
FYE 5/3	2008	2009	2009	2010	2011	2012	2013	2014	2014	2015
Sales	\$5,287	\$5,122	\$1,105	\$5,808	\$6,999	\$7,129	\$6,839	\$6,381	\$3,064	\$2,924
Gross profit	\$1,607	\$1,581	\$332	\$1,687	\$1,801	\$1,918	\$1,683	\$1,858	\$830	\$843
SG&A expense	\$1,405	\$1,438	\$335	\$1,602	\$1,857	\$1,971	\$1,902	\$1,822	\$872	\$845
EBITDA	\$371	\$317	\$43	\$300	\$189	\$185	\$14	\$259	\$70	\$101
EBIT	\$202	\$143	(\$3)	\$85	(\$56)	(\$53)	(\$219)	\$36	(\$42)	(\$2)
Net income	\$135	\$76	(\$2)	\$43	(\$69)	(\$65)	(\$158)	(\$47)	(\$74)	(\$16)
Diluted EPS	\$2.08	\$1.29	(\$0.04)	\$0.75	(\$1.22)	(\$1.34)	(\$3.02)	(\$1.12)	(\$1.40)	(\$0.43)

Cash flow stmts			3mos	x	x				6mos	6mos
FYE 5/3	2008	2009	2009	2010	2011	2012	2013	2014	2014	2015
Net income	\$135	\$85	(\$2)	\$37	(\$74)	(\$65)	(\$158)	(\$47)	(\$74)	(\$16)
Dep & amort	\$169	\$174	\$46	\$215	\$245	\$238	\$233	\$223	\$112	\$103
Non cash adjust	\$34	\$42	(\$1)	(\$63)	(\$31)	(\$32)	(\$50)	\$76	(\$6)	(\$4)
Working capital chgs	\$90	\$73	(\$190)	(\$58)	\$59	(\$165)	\$92	\$68	\$114	(\$28)
Cash fr operations	\$429	\$376	(\$147)	\$131	\$199	(\$24)	\$117	\$320	\$146	\$55
Capital expenditures	(\$194)	(\$192)	(\$22)	(\$128)	(\$111)	(\$164)	(\$166)	(\$135)	(\$70)	(\$73)
Dividends	(\$39)	(\$51)	(\$14)	(\$57)	(\$44)	(\$7)	(\$15)	(\$15)	(\$4)	(\$8)
Share repurchases	(\$248)	(\$201)	\$0	(\$3)	(\$2)	(\$4)	(\$6)	(\$5)	(\$8)	(\$3)
Other	\$0	\$0		(\$188)	\$0	\$195	\$430	\$85	\$42	\$42
Est. free cash flow	\$110	\$58	#VALUE!	\$3	\$88	(\$188)	(\$49)	\$185	\$76	(\$18)

Balance sheets				x	x					
FYE 5/3	2008	2009	2009	2010	2011	2012	2013	2014	11/1/14	
Cash		\$282	\$87	\$61	\$59	\$268	\$161	\$340	\$285	
Total assets		\$2,879	\$2,664	\$3,706	\$3,596	\$634	\$3,732	\$3,538	\$3,836	
Total debt		\$0	\$0	\$360	\$313	\$10	\$9	\$232	\$64	
Preferred stock		\$0	\$0	\$0	\$0		\$575	\$575	\$580	
Shareholder equity		\$923	\$903	\$903	\$820	\$493	\$455	\$631	\$628	
Shares out. Basic			56.1	56.2	56.6	57.3	58.2	59.0	59.3	
Core Retail Comp store sales				-5.3%	-8.3%	0.7%	0.1%	-3.1%		0.0%
College Comp store sales							-1.2%	-2.7%		-0.2%
Total stores (Year-end)				1,357	1,341	1,338	1,361	1,361	865	843
Adjusted EBITDA margin			3.9%	5.2%	2.7%	2.6%	0.2%	4.1%	2.3%	3.5%

Gross margin			30.0%	29.0%	25.7%	26.9%	24.6%	29.1%	27.1%	28.8%
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Valuation & Valuation Ratios

Market value	\$1,875
Net debt	(\$221)
Preferred stock	\$0
Enterprise value	\$1,650

Enterprise value / EBITDA	5.3
Enterprise value / EBIT	19.8
Enterprise value / Cash fr Ops	6.6
Ent. value / Free cash flow	16.6
Enter value / Sales	24%

			FYE	FYE	FYE	FYE	FYE	6mos	6mos
Sales by segment			May 10	Apr 11	Apr 12	Apr 13	Apr 14	Oct 13	Oct 14

B&N Retail			\$4,401	\$4,927	\$4,853	\$4,568	\$4,295	\$1,929	\$1,843
B&N College			\$834	\$1,778	\$1,744	\$1,763	\$1,748	\$964	\$977
NOOK			\$573	\$695	\$934	\$780	\$506	\$262	\$134
Elimination				(\$402)	(\$401)	(\$273)	(\$168)	(\$91)	(\$30)
Total			\$5,808	\$6,998	\$7,130	\$6,838	\$6,381	\$3,064	\$2,924

Sales by product line

Media					66%	67%	68%	69%	71%
Digital					15%	12%	9%	9%	5%
Other					19%	21%	23%	22%	24%
Total			0%	0%	100%	100%	100%	100%	100%

Depreciation and amortization

B&N Retail					\$163	\$149	\$126	\$64	\$54
B&N College					\$45	\$47	\$48	\$23	\$25
NOOK					\$25	\$31	\$43	\$21	\$20
Total			\$0	\$0	\$233	\$227	\$217	\$108	\$100

Operating profit

B&N Retail					\$161	\$227	\$228	\$37	\$37
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B&N College					\$71	\$65	\$67	\$42	\$23
NOOK					(\$286)	(\$512)	(\$260)	(\$121)	(\$63)
Total			\$0	\$0	(\$54)	(\$220)	\$35	(\$42)	(\$3)

Capital expenditures

B&N Retail					\$88	\$51	\$67	\$34	\$35
B&N College					\$41	\$39	\$38	\$21	\$25
NOOK					\$35	\$76	\$30	\$15	\$13
Total					\$164	\$166	\$135	\$70	\$73

EBITDA

B&N Retail		\$337	\$259	\$324	\$376	\$354	\$101	\$92
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Total		\$281	\$163	\$179	\$7	\$252	\$66	\$98

Quarterly Balance Sheets										
				FYE				FYE		
	July 12	Oct 12	Jan 13	Apr 13	July 13	Oct 13	Jan 14	Apr 14	July 14	Oct 14
Cash and equivalents	\$20	\$470	\$214	\$160	\$80	\$297	\$490	\$340	\$180	\$285
Receivables	\$154	\$234	\$396	\$149	\$151	\$193	\$297	\$144	\$120	\$158
Merchandise inventories, net	\$1947	\$1797	\$1785	\$1411	\$1748	\$1592	\$1442	\$1235	\$1684	\$1545
Prepaid expense and other	\$192	\$144	\$116	\$117	\$82	\$165	\$136	\$117	\$79	\$174
Deferred taxes		\$135	\$126	\$210	\$210	\$190	\$170	\$145	\$142	\$142
Total current assets	\$2313	\$2780	\$2637	\$2047	\$2271	\$2437	\$2535	\$1981	\$2205	\$2304

Net PPE	\$597	\$585	\$573	\$585	\$562	\$555	\$530	\$491	\$479	\$470
Goodwill	\$519	\$515	\$514	\$495	\$495	\$495	\$495	\$493	\$493	\$493
Intangible assets	\$563	\$558	\$553	\$548	\$544	\$539	\$533	\$529	\$524	\$520
Other non- current	\$63	\$57	\$63	\$57	\$55	\$52	\$48	\$45	\$48	\$48
Total assets	\$4055	\$4495	\$4340	\$3732	\$3927	\$4078	\$4141	\$3539	\$3749	\$3835
Accounts payable	\$1289	\$1348	\$1257	\$805	\$1196	\$1226	\$1136	\$735	\$1101	\$1184
Accrued liabilities	\$540	\$526	\$617	\$569	\$512	\$544	\$629	\$503	\$402	\$434
Gift card liabilities	\$313	\$297	\$387	\$341	\$329	\$314	\$392	\$357	\$339	\$328
Short term note	\$0	\$0	\$0	\$0	\$0	\$127	\$127	\$127	\$127	\$0
Total current liabilities	\$2142	\$2171	\$2261	\$1715	\$2037	\$2211	\$2284	\$1722	\$1969	\$1946
Long term debt	\$303	\$338	\$0	\$77	\$8	\$105	\$0	\$0	\$0	\$64
Long term deferred taxes	\$242	\$267	\$247	\$231	\$246	\$231	\$256	\$212	\$220	\$217
Other long term liabs	\$359	\$393	\$421	\$420	\$437	\$323	\$331	\$367	\$367	\$400
Redeemable preferred shares	\$193	\$193	\$193	\$194	\$194	\$194	\$194	\$195	\$195	\$195
Preferred Member interests in NOOK	\$0	\$289	\$381	\$382	\$382	\$383	\$383	\$383	\$384	\$384
Shareholders' equity	\$815	\$843	\$837	\$714	\$623	\$631	\$691	\$659	\$614	\$628

Quarterly Consolidated Income Statements										
				FYE				FYE		
	Jul 12	Oct 12	Jan 13	Apr 13	Jul 13	Oct 13	Jan 14	May 14	Aug 14	Oct 14
Sales	\$1454	\$1885	\$2224	\$1277	\$1300	\$1734	\$1996	\$1322	\$1236	\$1688
Costs of sales and occupancy	\$1038	\$1402	\$1670	\$1046	\$961	\$1272	\$1392	\$898	\$854	\$1228
Gross profit	\$416	\$483	\$554	\$231	\$369	\$462	\$604	\$424	\$382	\$460
Selling and admin expenses	\$410	\$416	\$494	\$356	\$377	\$386	\$430	\$413	\$353	\$392
Depreciation and amort expense	\$58	\$58	\$56	\$56	\$55	\$54	\$54	\$54	\$50	\$50

Operating profit	(\$52)	\$9	\$4	(\$180)	(\$63)	\$22	\$120	(\$43)	(\$21)	\$19
Interest expense	\$9	\$9	\$9	\$10	\$8	\$8	\$8	\$7	\$6	\$5
Income before taxes	(\$61)	\$0	(\$5)	(\$190)	(\$71)	\$14	\$112	(\$49)	(\$27)	\$14
Income taxes	(\$21)	\$0	(\$1,432)	(\$75)	\$15	\$1	\$48	\$12	\$2	\$1
Net income	(\$40)	\$0	\$1,427	(\$115)	(\$86)	\$13	\$64	(\$37)	(\$29)	\$13

Quarterly Segment Income Statements										
	Jul 12	Oct 12	Jan 13	Apr 13	Jul 13	Oct 13	Jan 14	Apr 14	Jul 14	Oct 14
Retail Sales	\$1119	\$996	\$1505	\$948	\$1008	\$921	\$1410	\$956	\$955	\$888
College Sales	\$221	\$773	\$517	\$252	\$226	\$738	\$486	\$298	\$226	\$751
NOOK Sales	\$192	\$160	\$316	\$112	\$153	\$109	\$157	\$87	\$70	\$64
Elimination	(\$79)	(\$45)	(\$114)	(\$35)	(\$58)	(\$33)	(\$58)	(\$19)	(\$15)	(\$16)
Total	\$1454	\$1885	\$2224	\$1277	\$1330	\$1734	\$1996	\$1322	\$1236	\$1688
Retail Gross Profit	\$337	\$293	\$504	\$262	\$301	\$270	\$471	\$297	\$295	\$266
College Gross Profit	\$51	\$168	\$110	\$76	\$50	\$168	\$117	\$103	\$47	\$174
NOOK Gross Profit	\$26	\$19	(\$60)	(\$107)	\$17	\$24	\$16	\$25	\$41	\$21

Total Gross Profit	\$414	\$481	\$554	\$231	\$368	\$462	\$603	\$424	\$383	\$460
Retail SG&A Expense	\$262	\$265	\$288	\$208	\$236	\$234	\$271	\$243	\$229	\$240
College SG&A Expense	\$65	\$80	\$76	\$72	\$69	\$84	\$81	\$89	\$79	\$94
NOOK SG&A Expense	\$83	\$70	\$130	\$75	\$72	\$69	\$78	\$81	\$45	\$58
Total SG&A Expense	\$410	\$416	\$494	\$355	\$377	\$386	\$430	\$413	\$353	\$392
Retail EBITDA	\$75	\$28	\$216	\$54	\$65	\$37	\$200	\$53	\$66	\$25
College EBITDA	(\$14)	\$88	\$34	\$4	(\$19)	\$84	\$35	\$14	(\$32)	\$80
NOOK EBITDA	(\$57)	(\$51)	(\$190)	(\$182)	(\$55)	(\$45)	(\$62)	(\$56)	(\$5)	(\$38)
Total EBITDA	\$4	\$65	\$59	(\$125)	(\$9)	\$76	\$173	\$11	\$30	\$68
Retail Core Comp Store Sales	+7.6%	+1.8%	-2.2%	-5.8%	-7.2%	-3.7%	-0.5%	-1.9%	-0.4%	+0.5%
College Comp Store Sales	-2.0%	-0.5%	-5.2%	7.5%	-1.2%	-3.6%	-4.0%	+2.6%	-2.0%	+0.4%
Net income										

Catalysts

1. Low valuation (10% FCF yield unleveraged; 4.5x FYE Apr 2015 EBITDA; 0.3x LTM revs).
2. Steadily build up in net cash position from \$300m at FYE April 2015 to \$500m at FYE April 2016.
3. Reduced operating expenses at NOOK decrease NOOK adjusted EBITDA losses.
4. Projected FYE April 2016 adjusted EBITDA of \$380m due to reduced losses at NOOK and stable results at Retail and College.
5. Recognition of highly cash-generative business model trading at low multiple.
6. Share repurchases and dividends from excess cash and FCF generation.
7. Possible acquisition of BKS by a strategic or financial purchaser.
8. Increased analyst coverage and recognition of BKS's attractive market position.

Risks

1. The U.S. and/or global economy declines, impacting BKS's business model.

2. BKS is unable to reduce NOOK losses as quickly as we expect.
3. Purchases of physical books decline faster than we expect over the next few years.
4. Amazon competitive pressure in online sales hurts Retail results more than expected.
5. Change in relationship with vendor partners.
6. Misallocation of capital into a poor acquisition.
7. Management turnover.
8. Large amount of stock options are outstanding; excessive management compensation

Disclaimer

Disclaimer: We own shares of BKS. We may buy or sell these shares at any time without notice. The information in the write-up is believed to be correct as of the date written but readers should do their own verification of this information and analysis of this potential investment. We undertake no obligation to update this write-up if new information arises at a future date.

I do not hold a position with the issuer such as employment, directorship, or consultancy.
I and/or others I advise do not hold a material investment in the issuer's securities.

Catalyst

See above

Messages

Subject NOLs?
Entry 03/11/2015 11:32 AM
Member MJS27

well done.

curious if you have any thoughts on what if any value they might be able to extract from past NOOK losses/NOLs etc.

thanks

Subject Re: NOLs?
Entry 03/11/2015 12:03 PM
Member andreas947

No....well done to you since you are up substantially on your idea and I am underwater at the moment.

I will talk to company and ask about NOLs but I think MSFT took a lot of the NOLs from NOOK and I am not sure the NOL at BKS is really that large, maybe \$50m or so.

I need to double check on that.

Thanks for your write up which prompted me to re-examine BKS. I note while the stock price is up a lot since your write up, the b/s sheet is dramatically better, especially after the MSFT and Pearson repurchase....consequently, the EV has not increased nearly as much as the stock price, which is a good thing (to me, at least).

Kudos again and I hope my write up works out as well. I will let you know what else I find out on the NOL.....Best, Andreas

Subject Questions about Nook
Entry 03/13/2015 02:09 PM
Member straw1023

MJS and andreas,

Other than reading both writeups, I am new to the idea so I apologize if this is a silly question. But as you note, if we only consider non-Nook, this trades at less than 8x unlevered FCF . . . seems pretty cheap for stable book biz plus growth-potential college biz.

So the question is how to think about Nook. Why should the negative numbers of Nook receive a multiple? Why don't they shut it down (or try to sell it for next to nothing)? Is it necessary to have a branded e-book solution (rather than simply have an app for Apple/Android/Windows)? If they shut Nook down, how does that affect the non-Nook biz? Are they keeping it open simply because they think they can win (they cannot) or is it a necessary loss-leader for the non-Nook biz?

Subject Re: Questions about Nook
Entry 03/13/2015 05:36 PM
Member andreas947

Straw,

Thanks for the question. Our thinking is that with the exit of Microsoft and Pearson, NOOK will need to stand on its own and either

grow revenues or right size its cost structure. CEO Huseby is an ex CFO with, we believe, a very sharp pencil. Even NOOK's content revenues are dropping steeply. In our view, the more they drop, the more it validates the physical book business remaining viable for a while, and the more aggressive we believe management will be in sizing NOOK's cost structure to fit its revenues. We are hopeful the NOOK cash burn will come down quite sharply. We see no reason BKS needs to invest in large NOOK losses going forward, for a business whose revenues, even on the content side, are falling sharply. As always, we could be wrong. But we expect and hope NOOK cash burn will come down sharply in next year or so.

MJS may have additional thoughts but we are definitely betting on a right-sized NOOK. Hope that helps.

Best, Andreas

Subject Re: Re: Questions about Nook
Entry 03/14/2015 09:51 PM
Member MJS27

I am increasingly of the view that physical and digital books have a different audience/clientele, but i think the reason NOOK isn't just shut down has to do with negotiating with publishers. it is likely helpful for BKS / more attractive to publishers to be able to ink one deal for physical and digital distribution through BKS.

that being said, i too am in the camp that NOOK will be right sized so that it is at worst a break even business.

Subject ...
Entry 08/24/2015 06:14 PM
Member MJS27

i realize alot of stocks have gotten "cheap" and they very well may get cheaper, but i think BKS is worth taking a look at here.

at current prices it yields about 4%, and w/ 2 turns of retail EBITDA worth of leverage they could buy back about 70% of the market cap. when you look at insider holdings and long term holders who are unlikely to start trading around their positions, they could basically buy back the whole float.

Aggressive buyback is extremely likely in the near future for a few reasons 1) their first post-spin meeting is coming up in early October, 2) incoming CEO is a Sears alum... clearly they had their own problems, but buybacks were a part of the playbook 3) controlling share holder Riggio is no stranger to buybacks as evidenced by what has happened at GME, which he also founded and 4) Liberty Media still owns 2% of the company and has a board seat.

NOOK remains a question mark but has been rationalized for the most part, retail sales are stable (and were relatively stable through the great recession) and in theory, any further broad market weakness in the coming weeks/months should be welcome as the company can just be that much more aggressive with their buybacks.

at this point, i think the biggest risk is that they just try to steal the company via take under if the global economy blows up.

Subject Re: ...
Entry 09/09/2015 04:23 PM
Member MJS27

would love to hear any thoughts here Andreas...

I have clearly been bullish on this for awhile, and am shocked at the carnage today.

In my eyes, this is now a "You Can Be A Stock Market Genius" wet dream between the post spin dynamics, the "good co / bad co" dynamics, and the potential levered re-cap dynamics. Throw in the impact of hedgies who are terrified of poor month to month performance given the recent volatility, and there is basically something for everyone who is a fan of Greenblatt's book.

Yes there was some operational de-leveraging at Retail, but at around 5x trailing Retail FCF that is more than priced in.

Only major surprise I saw in the Q and on the call was that they did not announce buy back plans today... if they had, the stock prob would have been up 10% instead of down 28%... and when the investment is a return on capital story, lower prices are better for the patient investors. With an almost 5% yield I can be patient. I added to my position.

PS - somewhat odd that the Maxim Group analyst - who has been a raging bull - wasn't on the conference call, and Rich Schottenfeld, who has asked management about a buyback on just about every call for the last few years was not on the call.

Subject Re: Re: ...
Entry 09/09/2015 05:43 PM
Member cnm3d

Without being fully up to speed here, it's a fairly levered company (BKS has like \$300MM in annual rent expense on EBITDAR of \$550MM) and it just totally whiffed on numbers - worst Q1 retail performance since 2011. I was under the impression it was supposed to beat this Q because of Watchman/50 Shades. Retail GMs declined after a period of expansion.

I'm a little surprised it's down 30% on non-holiday miss, but I'd have been shocked at under 15%. No take on trading from here, but this isn't some unlevered gem business. I'd be very worried long BKS if we actually have a recession (which I don't think we will, but still).

what kind of FCFE are you getting? i guess if EBITDA bounces back and you ignore Nook loses, plus a 35% tax rate and retail capex of say 2% of sales, you're talking about \$2 in earnings. So 6x = it's cheap, but you're also long a very cyclical business with clear competitive threats, pretty decent leverage (~4.5x, though how much will cash be up post Christmas? maybe its more like 3x?), and instead of distributing that cash to shareholders they are reinvesting in money losing Nook business, which I'd guess if they shut down would pretty much piss off their core customers so i doubt they ever do it?

with nook losses, it's like \$1-\$1.20 in FCFE, and that's probably a declining number. 10-12x feels right. i'm not sure how to think about nook, but closing it would likely result in sharply negative comps so i guess theyd stick with it? the hope is MSFT pays for yet another 3rd rate tech product?

im trying to understand the path to upside here. what do you think its worth, not on EV/EBITDA, but on real cash flow to a shareholder.

Subject Re: Re: Re: ...
Entry 09/09/2015 07:07 PM
Member MJS27

a few things to consider... of course you are "correct" to consider rent expense as leverage, but given that greater than 50% of the leases are up in the next 3 years, and only ~3% of the stores are not profitable, i would argue that it is overly punitive to give the leases a full negative accounting in this instance.

as for cyclical, i also don't see a recession on the horizon, but i would note that core book sales are likely less cyclical than you realize. the numbers are a bit fudged b/c the company shifted its calander year in 2009, but from 2007 - 2008 retail sales were down something like 4 or 5%, which isn't great, but it isn't a nightmare either when one considers the depth of the recession and that AMZN was more ascendent vs BKS at the time (ie alot of the AMZN damage has already been done - there remains a core population of people that actually like going to a physical book store). Of course the mix has shifted toward educational toys, which are likely more economically sensitive than books.

As for NOOK, i don't at all think shutting it down would piss off their core customers. I really don't think there are many (any?) people that buy a physical book and an ebook of the same title and switch back and forth depending on when they want to read

physical or digital. There is a mounting body of evidence that ebook sales are past their peak b/c people actually enjoy being away from a screen during their leisure time. Additionally, over the last few years there has been a resurgence of independent book stores, none of which have a digital presence, suggesting that a physical bookstore can work w/o a digital presence. This was alluded to on the call when they referenced different formats - ie smaller - that they were exploring.

Importantly, they are continuing to rationalize/outsource NOOK (ie not really reinvesting all that much at this point), and i think worst case NOOK will be a breakeven business at some point in the near future - there is really no need to run NOOK as a loss leader. As for MSFT, they are basically out of the picture at this point. The real point is that ex NOOK, cash flow from Retail will be allowed to shine.

The hope is really that management just acts rationally and follows the Best Buy / Gamestop / Outerwall playbook and buys back a ton of stock. While each of those companies is clearly unique, each is similar to BKS in the sense that they are secularly pressured consumer cos that still generate cash, and each of them ~doubled following aggressive buybacks and increased per share metrics despite declining enterprise level metrics. GME is actually a BKS spin off so Riggio surely knows the playbook, Liberty still has a board seat at BKS (despite basically exiting their position), the new CEO formerly worked at Best Buy and under Eddie Lampert at Sears Canada, so everyone here knows the power of buybacks. When the stock is trading at a 5% dividend yield and you can borrow money for dirt cheap, it is literally insane to not buy back stock. The big risk is actually probably that they intentionally manage expectations down and do a take under.

In terms of what its worth not on EV / EBITDA, while it is admittedly simplistic, i would just start with a yield basis as it is unlikely the dividend is pressured any time soon. Best Buy yields like 2.5%... is Best Buy that much better of a business than BKS that BKS should trade at 5%? Maybe it is better, but it is not twice as good, so lets say BKS should have a 3.5% yield - that is 50% upside from here inclusive of 1 year of dividend assuming constant share count. Model in some buybacks and the upside grows real fast.

In terms of cashflow, last year retail did something like \$230M in EBITDA-capex. with no interest expense and 35% tax thats \$150M in FCF. I realize this is likely to decline on an enterprise basis, but on a per share basis its likely to go up due to buybacks, so for simplicity sake right now call it a wash and put 10-12x on it and you have significant upside. that of course assumes some linearity, but in reality NOOK won't be break even overnight so the company will be able to be aggressive with their buybacks, which obviously just leads to greater upside later when NOOK eventually reaches breakeven.

In sum, just about all of my BKS eggs are in the "aggressive buyback" basket, with a few of them in the "just focus on the cash flow from Retail and pretend NOOK is gone" basket, which might be a mistake, but from my perspective it is usually a safe bet to bet on presumably self interested owner operators doing the smart thing (buying back stock and not continuing to dump good money after bad), and if this investment does not work out from here, i don't think it will be b/c of secular pressure - rather it will be due to my mis-reading of man's tendency to follow incentives.

*It also may be worth noting that somewhere buried in NOOK there is a massive NOL. I have no idea if this is recoverable at all now that NOOK and Retail are under the same umbrella (NOOK was previously attached to Education), but if anyone can figure out a way to squeeze some value out of those NOLs, it is John Malone's team, so maybe 35% tax on Retail is too high?

Subject Re: Re: ...
Entry 09/09/2015 11:50 PM
Member andreas947
 Hi MJS,

It was clearly not a great quarter but share price seems an over-reaction to us, a couple points to consider

* Q1 is not a large portion of EBITDA for the year for retail;

* there were some one time items in retail EBITDA which reduced Q1 number, although with a 1% comp we would have expected closer to flat retail EBITDA;

* Nook losses continue to come down and will be lower in 2016;

* mgmt was not great on conference call and seemed to play down buyback but interesting they have a \$700m credit facility which is unused;

* retail and Nook did about \$250m of EBITDA in 2015 adding back one time items and Nook losses should be less in 2016 and capex budget is \$95m;

* digital book sales continue to be terrible, which indicates potential staying power of physical books;

We hope to talk with company over next few days and will update any thoughts. We continue to think stock price is an over-reaction but clearly not a great quarter and we will have to see what happens.

Sorry for the lousy start to this idea..We continue to like it....Best, Andreas

Subject Questions
Entry 09/10/2015 03:44 PM
Member blaueskobalt

Thanks for the post. I'm taking a look after yesterday's fall, and I wonder if anyone has answers to the following questions:

1. CapEx: Retail CapEx has increased the past two years, despite a decrease store count. Why? Has the company given any indication of normalized CapEx?
2. Other than the in-store NOOK sales, are there material synergies between NOOK and retail? Is there evidence that it increases the stickiness of retail customers?

Thanks!

Subject Re: Questions
Entry 09/10/2015 06:15 PM
Member MJS27

Recent capex has included spend for a complete overhaul of the website, with the new site having just launched a month or 2 ago, as well as some spend on improving their distribution network. If all goes as planned both initiatives will lead to lower expenses going forward.

as for Nook, I haven't seen anything related to customer stickiness.

Subject Re: Re: Questions
Entry 09/14/2015 09:18 AM
Member wolverine03

Len Riggio bought 1mm shares in the open market. He already owned 12mm, and spending \$13mm of his own money seems pretty significant to me. I don't really take a view on him, but I know there is definitely a perception that you generally want to be on his side and not against him...

Subject Re: Re: Re: Questions
Entry 09/14/2015 10:29 AM
Member MJS27

This is fantastic news. The main threats I saw to the buyback thesis were that going back a few years to the crisis era Riggio had made comments about not wanting any more exposure to retail. That was clearly a different time, but it did give me pause as to whether or not he would have misgivings about a buyback. The fact that he is buying personally clearly illustrates that he sees value here, which gives credence to the buyback theory. Further, it may help explain why there was no mention of a buyback on the call when it is so obvious that buyback is an excellent use of capital at this point. Additionally, the fact that he is buying in the open market rather than trying to orchestrate a take under at these low prices reduces the risk that management will manage expectations downward so that they can take private at a lower price.

Subject ...and it begins...
Entry 10/20/2015 09:04 AM
Member MJS27

New York, NY (October 20, 2015)—Barnes & Noble, Inc. (NYSE: BKS) today announced that its Board of Directors has authorized a new stock repurchase program of up to \$50 million of its common shares. Stock repurchases under this program may be made through open market and privately negotiated transactions from time to time and in such amounts as management deems appropriate. The repurchase program has no expiration date and may be suspended or discontinued at any time.

\$50 million is small potatoes considering their capacity, but of course if they announced a huge buyback the stock would rip more, and they'd have to pay higher prices, so \$50 million seems like a good starting number.

The stock is trading at somewhere around 6 or 7 times core retail cash flow, so buybacks are a great use of cash. No reason why the company shouldn't follow the Best Buy / Game Stop / Outer Wall playbook going forward, and it's not hard to model in 100% upside as the business performs so-so and the equity shrinks significantly.

Subject Dislocation
Entry 12/04/2015 10:47 AM
Member maggie1002

Andreas, wonder if these consecutive dislocations give you pause or makes you an incremental buyer? Thanks in advance.

Subject Re: Dislocation
Entry 12/04/2015 05:32 PM
Member andreas947

Hi Maggie.

the last two quarters of "dislocations", as you generously put it, give me pause here and the execution issues and lack of aggressive cost focus by the new CEO also give me a lot of concern. i had hoped retail could hold EBITDA flat with prior year and that is clearly not going to happen. i have lost some confidence in the business model and the management team here. they have not cut NOOK losses as much as i hoped. i still like the under-levered b/s and big credit line but if they can't hold EBITDA stable here there are fair questions about what terminal multiple it ought to get. Obviously the market valuation is lower but i sure liked the prior CEO better in terms of aggressive execution. i would proceed with caution and i apologize for the (so far) really bad idea, i really had high hopes here.

Andreas

Subject Re: Re: Dislocation
Entry 12/04/2015 06:18 PM
Member MJS27

if i could chime in... first, i agree that things are not as good as i had hoped, or more importantly - as they could be - but this has never been a "this is a great business" investment for anyone. i also agree that it is unfortunate that new management has not been more aggressive. that being said, there were a number of one time items in the numbers, and as with any other business that is shrinking revenue (on a top line basis, not necessarily on a SSS basis) there is a lag between revenue decline and expense optimization (ie if you close a store, box level revenue goes to 0 immediately, but box level expenses (rent, severance, etc) continue for some time. corporate level expense reduction will also lag. the fact that they are targetting 1-2% reduction going forward is a good thing, and there is likely low hanging fruit. BKS' sales model is very low pressure. there are likely 3 types of shoppers - the ones that want the new hot release that kicks you in the face when you walk in the door, the ones that are regulars and thus know their way around the store, and the ones that are browsing for a random read or a gift for a friend. in all cases, most shoppers probably think that less is more in terms of engagement on the floor. there is some very low hanging fruit - like for example self checkout - especially in a business where "slippage" is likely below average for retail (just a guess that the erudite among the broader population are less likely to steal than the people shopping at teen clothing stores and walmart).

second, at least for me, this has always been an "owner operator will act in his best interest investment" which essentially means return of capital and more specifically massive buyback. disappointing to see 0 buyback this quarter, and the "blackout" is weak sauce in my mind, but management said something along the lines of, "we will take a look at the stock price and our internal estimates of what shares are worth and then decide how aggressive to be with the buyback." well, riggio just bought a million shares quite a bit higher than where the stock is now, so that gives a pretty good hint as to what they think the stock is worth, so in theory, they should be real aggressive. further - and this is basically impossible for "wall street" to get their head around - but if the real play is buybacks, lower prices in the near term are better for the long term (see my last point for more).

third, they were more bold than ever on their NOOK stance. they pretty much acknowledged that the business sucks, and they are going to do something about that. i hope they kill it, and their tone suggests they are considering that, but who knows.

fourth, 6% yield and buying back stock is attractive no matter how you slice it. of course the question is is the dividend sustainable... but the fact that they are cancelling store closures b/c business is better than expected suggests that it is... and again, there is low hanging fruit on the expense side and there are one time or short term items obscuring the real cash flow generating ability of the business.

fifth, a small store footprint makes a ton of sense. low start up costs, reduced stocking costs, higher turn, and empirical evidence that small book stores are doing well nationally.

lastly, discount everything i say because i think i have become emotionally involved here and have actually been pondering whether i should remove myself from VIC so as to avoid this problem in the future. in any case, i think the STOCK is ridiculously cheap, but this is a market that only wants to love BUSINESSES that have real (or imagined) growth potential, and this is not a BUSINESS with huge (or any, outside of small store) growth potential, so the really cheap STOCK is getting cheaper and cheaper.

Subject holiday sales
Entry 01/07/2016 09:04 AM
Member MJS27

core comparable holiday sales up 1.6% after being up 1.7% last year. doesn't smell like a business on its death bed to me.

7% yield, rock solid balance sheet, management incentivized to kill an underperforming business, a clear path to engage in insanely accretive buybacks, empirical evidence that small store format works in both the US and the UK (http://www.slate.com/articles/business/moneybox/2015/12/barnes_noble_is_dying_waterstones_in_the_u_k_is_thriving.html).

if they just act rationally and kill NOOK and buyback stock not hard to argue that this is worth 3x.

Subject sell-off seems overdone
Entry 02/03/2016 12:16 PM
Member mrsox977

Down big on Amazon news (AMZN to open physical bookstores). This is not new news btw.

IMHO, AMZN validates that people want physical locations.

If BKS can keep buying back stock, rationalizing cost, and one day conceive of killing NOOK, the upside here is substantial.

BKS's SBUX cafes + the value of the Nook Digital Library are large components of value on their own and could also be monetized.

Nice dividend while you wait.

Curious on other members' thoughts.

Subject Re: sell-off seems overdone
Entry 02/03/2016 01:28 PM
Member aa123

Why wouldn't Amazon just buy BKS?

Subject Re: sell-off seems overdone
Entry 02/03/2016 02:40 PM
Member MJS27

the bear case has been that physical stores are dying, yet the evidence continues to mount that physical stores mount. AMZN validating physical presence can be considered the latest data point, although AMZN's history of being profit-agnostic should also be considered.

between insider ownership and ownership by solid, deep value investors like Abrams and Tisch (both of whom have been buying btw), a large portion of the float here is locked up, and given that the bear case is very easy to believe if you don't do some original thinking, the stock is easy to push down.

to me it makes no sense to sell BKS on the AMZN news - in my mind the validation of the physical model should carry more weight than the prospect of an entity with almost zero retail experience setting up shop and damaging BKS who has decades of experience in retailing. lets not forget that it will take a few years for AMZN to roll out a few hundred stores, and if BKS would just kill off NOOK and tighten up operations a tad it would be trading at less than 4x retail FCF...

as for why AMZN wouldn't buy BKS, i would guess that AMZN will go smaller footprint, which is something that BKS is exploring themselves.

Subject Validating the value of retail locations
Entry 02/03/2016 02:52 PM
Member zzz007

If AMZN is indeed looking to open up a couple of hundred locations, it makes sense to remember that their goals are likely far broader than providing physical locations from which to sell books. AMZN has, for some time, been looking for ways to ease the logistics around same-day delivery and, in addition, deal with the issue of getting deliveries to customers who aren't at home. If I'm not mistaken, they're already piloting the model of renting out locker space in other retailers' locations expressly for this purpose. So, to the extent they open a retail location, my guess is that a major reason will be to facilitate same-day pickup of non-book merchandise, etc. As such, I'm not sure to what extent you can really call their plans a validation of the bricks and mortar book buying experience. There are a lot of other potential considerations at play.

Subject Re: Validating the value of retail locations
Entry 02/03/2016 03:24 PM
Member MJS27

valid points for sure. i envision what the media is calling AMZN's "book stores" to be some sort of pickup / warehouse location as you described, with shelf stable merchandise such as books or other items that lend themselves to impulse buying.

in any case, in regards to today's price action my view is either 1) AMZN is entering the physical book market which validates the model to some extent = not automatically negative for BKS or 2) AMZN is setting up retail distribution points, and the media is erroneously calling them bookstores = not automatically negative for BKS.

in any case, the chart looks like crap, every jobber in the world can tell you why they think the company is screwed regardless of the fact that they have never read past the revenue headlines, and a large portion of the float is locked up (by very smart guys) so the stock trades down very easily. market continues to disregard the fact that the presumably self interested owner operator who is clearly familiar with the power of buybacks through his involvement with GME could set off a massive move to the upside by buying back stock aggressively and killing off the shtty nook business.

the investment is going to work or not work based completely on what Riggio does, not on the (mistaken in my opinion) belief that bricks and mortar book selling is dead. if Riggio follows the GME, BBY struggling retailer playbook, the stock is a double or maybe a triple. if he doesn't, and rather chooses to continue to light money on fire with the NOOK forever, then its not going to work.

Subject Re: Re: Validating the value of retail locations
Entry 02/03/2016 04:31 PM
Member OsoNegro

How about we invert the question here?

Why isn't AMZN opening physical stores in other categories? If this was solely about distribution points...why isn't AMZN opening 300 electronics stores? Or 300 clothing & apparel stores?

Amazon has more data than God on countless retail items. Yes, they are not as profit-focused as most retailers, but they aren't stupid. Yes, AMZN enters many categories, but I don't think AMZN gets enough credit for being rational and quietly quitting when it does not make sense.

By that logic, I think this move DOES validate the physical book store model.

To aa123's question about M&A – Antitrust concerns makes acquiring BKS a non-starter.

Riggio bought 1 million shares at \$12.59 as recently as September '15. I think this is worth repeating. Several times. Out loud.

FWIW - I added to my position today too. Maybe I'm being smart, or too stubborn to accept defeat here. Honestly, sometimes I can't tell the difference anymore. ~Oso

Subject Re: Re: Re: Validating the value of retail locations
Entry 02/03/2016 05:08 PM
Member urban

They fully intend to do other categories, it's natural to launch in one category first and it's natural for books to be that first category

Subject Re: Re: Re: Validating the value of retail locations
Entry 02/04/2016 08:56 AM
Member Shooter McGavin

I may be speaking out of school here, but can't books generally be returned to publishers, thereby exposing amzn to less inventory risk by going the books route (and not clothes or electronics)?

And it's out there, but could stores maybe be a foray into reverse supply chain?

Subject Update?
Entry 03/04/2016 03:06 PM
Member straw1023

andreas,

Mr Market has certainly been manic in the case of BKS recently.

Now that the dust has settled on the holiday season, what are your updated thoughts?

Even with the promised \$30mm in SG&A cuts, what do you see sustainable retail EBITDA as going forward? We see \$300mm max.

Does it bother you that while non-nook bookstore sales were up, they are increasingly depending on adult coloring books, vinyl records, and games? Are these too trendy?

And what about the future of the online business? Do you have any optimism this can become a source of growth?

Making Nook a \$100mm liability, the stock trades about 6-7 times unlevered FCF with stock at \$11.50. So lots of bad news still priced in here. But I am finding it more and more difficult to believe that retail will not slowly decline rather than stabilize or even grow.

thanks

Subject Re: Update?
Entry 03/07/2016 04:21 PM
Member MJS27

straw - curious what you think is the right multiple to put on retail EBITDA?

struggling retailers GME and BBY currently trade around 4.25x and have traded as high 6x as recently as a few quarters ago. I struggle to see why BKS wouldn't deserve a higher multiple than both GME and BBY as BKS has a more defensive product, a better lease structure, a more viable plan to adapt the business (small store format works for books in a way that it won't for electronics), lower touch sales force, capex < D&A, better balance sheet, and better return of capital opportunities.

At 5x, putting -\$100M on NOOK gets you something like 60% upside and you get paid 5% to wait, with further upside from aggressive buybacks, the possibility that they pull their heads out of their ass and kill off NOOK, and a lotto ticket in the form of John Malone & Co figuring out something to do with the ~billion dollars of NOLs attached to NOOK (obviously a long shot, but who knows?). Additionally, in my view these struggling retailers should really be private, and with Riggio @ 75 years old, it seems that BKS is both more likely to be sold, and easier to be bought by P/E.

Subject Re: Re: Update?
Entry 03/07/2016 05:04 PM
Member straw1023

MJS,

My thoughts below. I hope we also hear from Andreas who has been frank about this name.

I am a bit more pessimistic than you. I do not like the shifting product mix. And I am less optimistic about BN.com becoming growth engine going forward. And I am not confident we will not see a slow decline in EBITDA going forward. However, I like what I hear from management in terms of costs and capital, which puts a floor on valuation.

So I have fair value at 4.5x \$300mm EBITDA (about 9x unlevered FCF) less \$100mm for Nook. My range of value has narrowed as management has given me confidence on downside but I do not think the stable margins and low-single digit growth thesis is going to play out as we had hoped a year ago.

Like you, I think BKS (retail) deserves to trade at a premium to GME/BBY. I have no interest in being long GME/BBY at these levels.

Like you, I also see a more likely (than GME/BBY) catalyst in a going-private transaction here. Another catalyst is doing something with Nook to limit the damage.

On the flipside, I am of the opinion that if Amazon does go with a retail strategy, it is decidedly bad news for BKS. I know there were conflicting opinions offered here.

So, all-in-all, we think fair value is \$16-ish (a year ago I had it in low 20s), and we have lightened our position in this rally. Given the news flow since early Dec, I liked this more at \$12 4 months ago than now.

BKS has been indicative of overall market. The hedge fund bloodbath has not resulted in cheap high quality companies. Instead, the mis-pricings have been found in lower-quality companies with bad news where market has over-reacted (as when BKS traded to \$8).

Subject Re: Re: Re: Update?
Entry 03/07/2016 08:26 PM
Member nychrg
 straw1023,

Thanks for your comments. Can you please share how management has given you comfort on the downside? We looked at this recently but were concerned that lower Nook expenses were masking a declining business, albeit one that generates a lot of FCF. If the retail biz is stable this is far more interesting, however what if anything gives you this comfort?

Thanks

Subject Re: Re: Re: Re: Update?
Entry 03/07/2016 09:11 PM
Member straw1023
 nychrg,

As I said, I also believe retail is slowly declining and why I think that it does not deserve the low teens multiple (of unlevered FCF) that I had thought it deserved. You are not going to get a strong bullish argument from me and why we have reduced our position here.

I do not have call transcript in front of me, but mgmt has said and done right things re:

- Nook expenses and open to a strategic move re: Nook
- retail SG&A expenses
- FCF return

The one thing I would like to hear them discuss more is reduced retail capex -- if/when does it make sense to go in the KMart/ToysRUs direction?

But my point was that if I have a slowly melting ice cube and management is returning cash flow to shareholders, I have some comfort on the downside. Compare with situation where management was full throttle on Nook, re-investing in stores, and looking for acquisitions . . . then the downside is zero. Unless Amazon comes in with blowout national strategy, I have downside case as \$8-ish.

But at this price, there is downside possibility even if mgmt behaves optimally. And I now think the upside is limited based on the latest results although a go-private transaction does make sense and might provide the catalyst for immediate upside. But I do not like longs where the main upside is getting taken out.

Subject Re: Re: Re: Re: Re: Update?

Entry 03/07/2016 09:35 PM

Member wolverine03

Isn't the other issue here that management is actually going spend cash on new store concepts? Will this ever get a reasonable multiple of EBITDA-CapEx with the overhang from Amazon stores?

Also, all of these numbers are assuming comps continue to be in the 1-2% range so the business doesn't deleverage meaningfully. The problem I had with this is that the economy is getting softer, and even if books are more insulated, everything will be hurt. I don't want to be around in this when they inevitably comp down 5%, and when that happens, the business will show a massive EBITDA decline because of the operating leverage. All of a sudden the EBITDA you're underwriting to is meaningfully lower, and in my view that means this lacks any real margin of safety. It may never happen, but if it does, it is basically too late and the stock will open at \$7 again. That's different from other businesses that could have a bad quarter and bounce back. I think in this case, it sort of feels like when sales go down, they don't come back.

Also, just FYI...I'm not trying to be a hater here. I was long this both pre and post spin...I just think it is a bet on terminal value and you're not likely to be rewarded for that until you get to the terminal year, which is mostly a moving target in the future. If you get to that year and you're wrong, it is too late and you're likely permanently impaired. That's no fun.

Subject Re: Re: Re: Re: Re: Re: Update?

Entry 03/09/2016 11:00 AM

Member andreas947

Straw, Wolverine,

While it was a pretty solid quarter and better than i expected, I would echo Wolverine's comments here. Not sure where this business might be in three to five years and disappointed they can't keep Retail EBITDA flat with these comps. Concerned that much of the value remains in the enterprise value over next few years and if Retail continues to struggle the market will not put a decent multiple on that. We will see how their programs to improve sales at Retail play out and they may work but looks like an uphill battle. We continue to own a small position and we could be surprised here but we remain cautious.

Sorry this idea has not worked out too well so far. Hope this helps.

Best, Andreas

Subject Re: Re: Re: Re: Re: Re: Re: Update?

Entry 05/31/2016 03:52 PM

Member MJS27

few things worth mentioning here over the last few weeks.

- 1) the American Bookseller's Association - an independent bookseller's group - noted that membership grew for the 7th year in a row. There are mutiple articles out there about how communities love their local, small store format bookstore etc. there are more opening every week.
- 2) data out of the UK shows that ebook sales have continued to decline, while physical book sales went UP last year for the first time in 4 years
- 3) WSJ had an article about a month or so back touching on a small format bookstore where they have a somewhat limited inventory, but the ability to print on a demand tens of thousand of books, which only takes a few minutes. Sales at this shop - which is in NYC - obviously should not be extrapolated - are \$1,000/sqft.
- 4) one negative thread tied to the small store concept is that the impact of higher wages and rent is felt hard.
- 5) BKS is slated to provide details on their nascent small format concept on their next call, which is due in a few weeks.

in sum, while BKS is priced like they're in terminal decline, there is strong evidence to suggest that they have a long future ahead of them, albeit in a smaller store format. the company's extremely flexible lease structure positions them well here as they could exit

most of their big boxes in just a few years with no problem.

There are a lot of ways that the small store concept could develop - notably to point #4 above, some sort of JV and/or franchise model would make a lot of sense as BKS' scale must give them an enormous COGS advantage vs independents.

that being said, Wolverine's point below is valid - it will not be an easy road to go from big box to small box (although I would argue that if you really think the economy is a problem, you shouldn't be in any stocks b/c the ETFization of the market will likely make just about everything a bloodbath, and the fact that BKS survived the recent retail bloodbath pretty much intact suggests there is some margin of safety here somewhere). Moving on to point 6)

6) Leonard Riggio announced he is stepping down as Chairman. He is 75 years old, with no heirs in the business. The stock is trading somewhere around 5x FCF from the core business with no debt, and I have to think that Riggio stepping down is akin to waving a flag that says, **"hey! private equity guys! we need to change our business a bit over the next few years, and we should really not be doing it as a public company... lets talk!"**

who knows how that plays out, but with a 5+% dividend yield, and a buyback that would be close to 6% of outstanding shares if fully executed this year, you get paid to wait.

the market pretty much hates anything and everything of uncertain duration at the moment, but the way i am loosely looking at this right now is that if retail sales stay about the same and they pull off the cost cuts they are talking about Retail should do something like \$300M in EBITDA-capex. A 5x multiple on that, plus 2 years of dividends, plus 2 years of buybacks and adjusting for cash on B/S gets me pretty close to a \$24 stock.

I am not dinging them for NOOK in the above - the above is just meant to be illustrative - i think there is a lot of meat on the bone here for P/E, and i think that is how this story will end for public shareholders.

in the mean time though, it is tough to own b/c 40% of the float is locked up between Riggio, Abrams and Tisch (pretty smart guys btw) which makes the other 60% super volatile b/c every wanna be day trader in the world thinks "bookstores are dead!" w/o ever opening the 10k.

Subject thoughts on the CEO's departure?
Entry 08/24/2016 05:35 PM
Member mrsox977
 Looks like Len is back in charge.

Subject Re: thoughts on the CEO's departure?
Entry 08/25/2016 04:51 PM
Member MJS27
 I don't know what to make of it. It certainly seems odd.

Riggio announced he was stepping down in April.

Presumably at that time he had faith in Boire, who had been on the job around 7 months at that point.

The investor day, which was Boire's "coming out party" was in late June.

Presumably Riggio still had faith in Boire at that time, and presumably he supported all that was said during the investor day.

Impossible to know what has changed between now and then, but seems likely it was something to do with differences in philosophy surrounding capital return policy, selling the business, or getting more aggressive on expanding into smaller format stores. Impossible to know who would have been on which side of which argument although if anything I would say that likelihood of a sale in the immediate future is diminished.

From my perspective, nothing has really changed. Owners of BKS are getting paid more than 11% (dividend + buyback) to own a business with a rock solid balance sheet that is comping flat to up with a lot of low hanging cost cutting fruit and a lotto ticket in the form of the small store concept. We have empirical evidence that small bookstores are doing well, and with 80% of the leases on the big boxes expiring in the next 4 years it won't be difficult for the company to completely recreate itself in the next few years. it'll be a bumpy ride, but 11% capital return smooths those bumps.

Also worth noting that while its impossible to discount this sort of thing, the opening of the small format stores in great locations is the kind of thing that causes sell side analysts to write reports promising a bright future due to high potential of a new concept. Wouldn't be surprised at all to see this stock rip through the holiday season as sell side wakes up to what is going on and starts pricing in higher sales per square foot, higher inventory turns, wider margins on alcohol sales, etc etc etc.

Would be curious to hear any other insights or ideas on why Boire got the boot.

Subject Thoughts on Sandell / activism
Entry 08/07/2017 02:47 PM
Member Thor25

Curious what long-time observers make of the situation here. My cut is that as a special situation this starts to look pretty interesting for the following reasons:

- 1) Len is old and the business has struggled, in the past he has been willing to undertake shareholder friendly initiatives (spin of BNED, Liberty / MSFT investments in Nook, spin out of GME). Why not try to sell now?
- 2) EBITDA of 200m on retail and maintenance capex of \$40m implies harvestable FCF of \$160m putting the stock at a little over 3x TEV / FCF
- 3) Comps are going to get easier as they anniversary the negative impact of turmoil from Boire's abrupt stop / start and coloring books and vinyl.
- 4) The dividend yield is north of 7.5% and they have a buyback, plus the stock is very close to all-time lows.

Subject Re: Thoughts on Sandell / activism
Entry 08/07/2017 03:28 PM
Member WinBrun

I agree. My issue is that it seems like you have to get a sale for this to really work. I guess you could get a temporary move up on a better than expected quarter. But based on where Sandell argues it could be valued--it probably has to be sold. Who are the buyers?

Subject Re: Re: Thoughts on Sandell / activism
Entry 08/07/2017 03:39 PM
Member Thor25

Yeah I am fairly confident that they will run a process but I'm not sure on the buyers. I think the math makes a lot of sense for PE but obviously there is a lot for sale in retail and few transactions have been completed. Strategic buyers seem like a longshot, though I don't disagree with his rationale that this could be a logical deal for a tech company, I still see any strategic as far fetched.

Since there is zero leverage on it right now and the mtk cap is so small, I think someone takes a flyer at \$10 - \$12. The math gets you to 20%+ IRR pretty easily in that range.

Subject Re: Re: Re: Thoughts on Sandell / activism
Entry 08/07/2017 03:43 PM
Member shoobity

Do you know when the capital lease accounting is going to change? Optically this is going to bang them although for a PE they are smart enough to understand this.

I assume their \$180M of ebitda is not after the new accounting lease changes.

Also capex is 100M and while we can argue that some of that is growth, just like the movie theaters this is probably all maintenance at this point?

Subject Re: Re: Re: Re: Thoughts on Sandell / activism
Entry 08/07/2017 03:46 PM
Member Thor25

IR claims 40m is maintenance and the rest has been related to new concepts / remerchandising efforts / cafe stuff. This reminds me of an OTR / CSTR situation though obviously you have a tougher fixed cost structure here than running kiosks.

Subject Re: Re: Re: Re: Re: Thoughts on Sandell / activism
Entry 08/07/2017 04:04 PM
Member shoobity

I use a general rule of thumb. If your revenue is going down then it's all growth capex outside of like a big mine or something obvious like that.

So they spend \$100M and maintenance is 40M so the other 60M makes sure they dont shrink double digits? Thats maintenance to me.

Subject Re: Re: Re: Re: Re: Re: Thoughts on Sandell / activism
Entry 08/07/2017 04:26 PM
Member Thor25

fair point, though obviously not all spend is efficient. OTR is an example of a company that was hyper focused on returning to growth when they should have been in harvest mode. BKS has arguably been doing the same thing for some time...this is a company that generated multiples of the market cap in cash from the core business over the past 8 years but reinvested it into the Nook and capex

Subject Author Exit Recommendation
Entry 08/08/2019 12:36 PM
Member andreas947

The author has recommended exiting the position