Tiburon Research Group

Earnings Preview: BBBY
September 21, 2009

BBBY Will Beat Consensus in Q2 2009 – Materially Greater EPS Upside in 2H 2009

We continue to see no material weaknesses at the store-level at **Bed Bath & Beyond (BBBY - $39.79)**. In addition, look for large-scale *SG&A* leverage in Q2 2009 as BBBY anniversaries incremental medical insurance and worker's comp costs.

BBBY finally reported much improved inventory numbers at the end of Q1 2009 and anniversaries an even more bloated inventory level in Q2 2009 than Q1 2009. Therefore, we fully expect inventory levels at the end of Q2 2009 to show even more improvement than Q1 2009.

Looking ahead, the company has even more EPS upside potential in Q3 2009 than Q2 2009. Why? Going forward, 2-year EBIT margin run rates are much easier to anniversary.

In Q2 2009, we're forecasting EPS of $0.53 versus the current consensus sell-side estimate of $0.48. Our estimate implies -1.0% comp store sales and a +134 Bps EBIT margin improvement versus LY.

In Q3 2009, we're forecasting EPS of $0.47 versus the current consensus sell-side estimate of $0.38. Our estimate implies +0.5% comp store sales and a +260 Bps EBIT margin improvement versus LY.

In FY 2010, we're forecasting EPS of $2.22 versus the current consensus sell-side estimate of $2.02. Our estimate implies +1.8% comp store sales and a +47 Bps EBIT margin improvement versus LY.

While little or no downside EPS risk, we do have the following concerns:

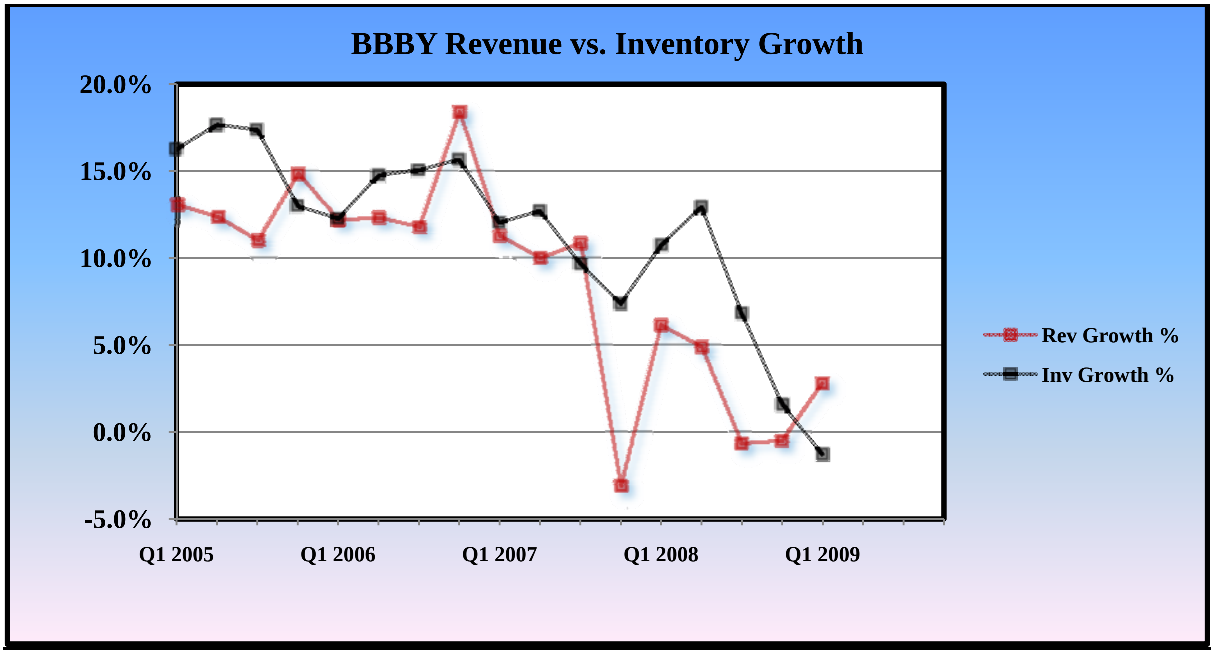
- Despite benefiting from the **ex-LIN** liquidation, BBBY is being negatively impacted in two areas. BBBY customers are redeeming coupons at a higher rate. In addition, the sales mix continues to shift towards lower margin home furnishings product.
- It's clear that the ***Christmas Tree Shops*** chain has a materially lower operating profitability versus the core business and increased *Christmas Tree* store count will only negatively impact total company profitability going forward.
- Keep an eye on inventory levels. BBBY has reported higher inventory growth versus sales growth in 13 of the past 17 fiscal quarters.
- The ARS debacle continues to limit share repurchases. At the end of Q1 2009, BBBY had $209.2 million of Auction Rate Securities (ARS).

BBBY Noteworthy:

- BBBY has a few streaks in play that, if broken, would be a bullish signals going forward:
    - BBBY has suggested that coupon redemption has been higher than LY for 7 straight fiscal quarters through Q1 2009.
    - BBBY has suggested that inventory acquisition costs (i.e. lower IMU) have increased in 9 straight fiscal quarters through Q1 2009.
    - BBBY has suggested that the company has experienced a negative impact from a sales mix shift towards home furnishings product in 9 straight fiscal quarters through Q1 2009.

BBBY Noteworthy (con't):

- BBBY's inventory levels BBBY has reported higher inventory growth versus sales growth in 13 of the past 17 fiscal quarters.



BBBY has struggled to control its inventory levels. Optically, inventory was somewhat better controlled at the end of Q4 2008, but BBBY reported its worst year-over-year inventory result at the end of Q4 2007.

Therefore, Q4 2008's relatively improved year-over-year inventory control came against an easy comparison.

BBBY reported a much improved inventory result in Q1 2009 and continues to anniversary even more bloated inventory numbers in Q2/Q3 2009.

- In FY 2008, BBBY spent $266.4 million (3.70% of revenue) on advertising (primarily coupons) versus $239.6 million in FY 2007 (-3.40% of revenue), $198.4 million in FY 2006 (-3.00% of revenue), and $158.2 million in FY 2005 (-2.72% of revenue).

- Commencing in FY 2008, BBBY changed its methodology for expected volatility when calculating stock-based compensation. The methodology is now the "average of historical and implied volatility" versus "solely on the implied volatility of the company's call options."

Earnings Preview: BBBY
September 21, 2009

BBBY Noteworthy (con't):

Recent BBBY notes in our weekly *Shopping Cart* reports:

Bed Bath & Beyond (BBBY - $37.12) – 08.28.2009
Several BBBY store associates suggested that sales company-wide are still "running only slightly below LY."

Though traffic is extremely high today at Bay Area stores and store associates are relatively upbeat, we are concerned that Q2 top-line trends may not necessarily improve versus Q1 2009. Several store associates suggested that "lower college freshman admission rates this year have had a negative impact" on the start of BBBY's all important BTS selling season (early-August). According to store associates, BBBY does more volume during BTS than Holiday.

That said, seasonal BTS merchandise has now largely sold-down in stores and overall inventory levels are significantly lower than June/July levels. Sales associates readily admit that customers have been trading-down to lower-priced merchandise. But we believe that BBBY has appropriately flexed its assortment in anticipation of the trend. Stores continue to emphasize lower price-points and sales associates suggest that "pricing has come down on a lot of items and is being passed to the customer."

BBBY also continues to run a huge *As Seen On TV* gadget business with new entries to the category including cascading *Wonder Hangers* and the *Slap Chop* food processor (it's "making America skinnier with every slap").

http://www.youtube.com/watch?v=rUbWjIKxrrs

BBBY store associates are typically very knowledgeable regarding company trends and the overall health of the business. Most recently, store level associates are touting BBBY's "thrifty culture." Associates cite unimpressive corporate offices floored with used carpeting, the lack of corporate jets, and in-house store maintenance as laudable attributes to the BBBY business model.

BBBY's new strategy of merchandising un-opened boxes of back-stock on the selling floor (more prevalent in higher-volume stores) is yet another smart cost-savings measure that may have the added benefit of subconsciously suggesting "value."

Bed Bath & Beyond (BBBY - $34.75) – 07.24.2009
We continue to get strong reads at Bay Area BBBY stores. Even stores in less affluent neighborhoods are suggesting improving trends. Most store associates confidently inform us that the business continues to improve. One store associate suggested that, "sales have been above LY all season and continue to pick-up."

In addition to benefitting from *Linens & Things* store closures, we believe BBBY's value messaging and improved product offering is also driving sales. Lower-priced merchandise such as *As Seen on TV* gadgets and value packs (e.g. *11-Piece Dorm in A Bag)* are driving sales today.

Clearance levels are light in stores today. Bedding markdowns are considerably lower than prior years. Clearance is mostly limited to discontinued lines.

We are also beginning to see discounting on lower-priced "better" offerings such as *25% off select Emeril* cookware (likely a vendor rebate similar to typical offers by *Calphalon* and *All-Clad*).