Barnes & Noble

NASDAQ:BKS

Analyst: Pierre Gouesclou
Sector: Retail

Sell

Price Target: $9.86

Key Statistics as of 04/30/2016

Market Price:	$11.75
Industry:	Specialty retail
Market Cap:	$877.9M
52-Week Range:	$7.25-18.99.
Beta:	1.18

Thesis Points:

- Barnes & Noble operates in a saturated market
- Too much Property, Plant & Equipment
- Their sales in store is decreasing
- Misses most of their estimates
- Barnes & Noble struggles to generate return on Investment

Company Description:

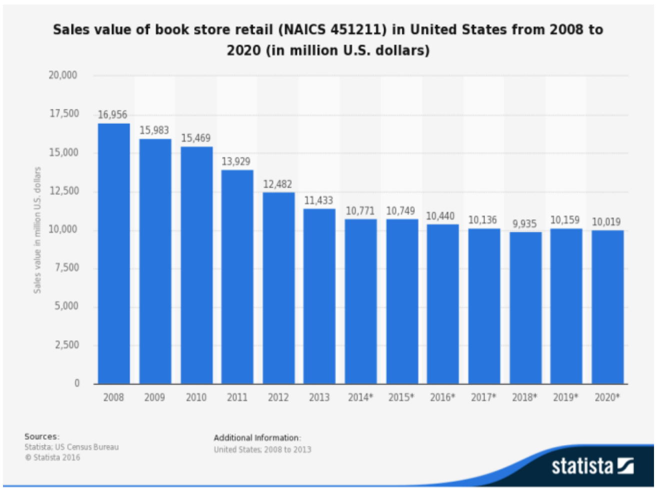
Barnes & Noble is a company operating in hardcover book and EBook retail mostly in the United-States. The New York City based company went public in 1993 with a stock price of $6.5 per share and has been familiar with success in the past. Recently, with the increasing weight of digital reading methods the company's revenues has been falling drastically, driving the stock price down from $18 to $12.55 a share. In order to overcome this existential threat the company began to launch digital products to appeal to the developing market of Book retailing. Since its issuance in 2009 the Nook tablet had been upgraded and the company created several partnerships to enhance the attractiveness and efficiency of the device.

Thesis

Barnes & Noble has tried to adapt to a changing market by developing their web and digital presence. This effort made by the company does not have any success as the weight of revenue generated by the Nook tablet keeps decreasing year by year. With the expect failure of the Nook tablet we can expect the company to soon collapse as they fail to compete with their online competitors such as Amazon. In the United-States but the company is burdened by their strong physical presence. Furthermore in the last years the company's cash flows has suffered from strong expenses related to the purchase of Plants and equipment.

Industry Outlook

The book retail industry has always been a very competitive market with low margins to be made by companies. In the last year with the rise of online retail and the creation of EBooks the competition increased massively leading to more competitive retail prices between the companies. This high competition triggered a reduction of margins for the companies that can prove fatal for brick and mortar companies such as Barnes & Noble. Companies that were able to adapt efficiently to this moving market were able to drain the sales from more traditional companies.



Porter's 5 Forces

Global Observations: Barnes & Noble has a very low porter's 5 Forces of 33 out of 100. This low score shows the danger of the company regarding the several attributes of their products and their presence on the market.

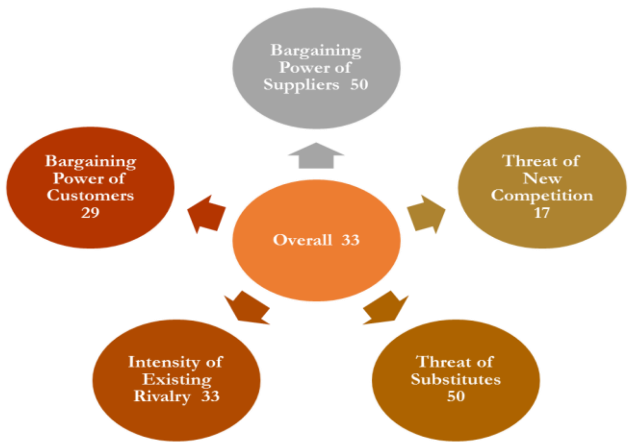
Bargaining power of suppliers: With a score of 50 the bargaining power of suppliers is the best force for Barnes & Noble. Given their line of Business the company pursues their business with suppliers of a very broad and diversified segment. In other word the suppliers of such goods are in number and proposes important amounts of products. Furthermore the cost of switching suppliers is very low and therefore Barnes & Noble can have more flexibility on this aspect of their business.

Bargaining Power of Customers: On the other hand Barnes & Noble is suffering deeply from the customers bargaining power with a score of 29/100. In a saturated and diversified market such as this one the customer is able to find substitutes with an equal quality. With the rise of the E-commerce and the digital reading the customer also gained in bargaining power.

Intensity of Existing Rivalry: The Existing Rivalry in this industry is massive given the important amount of competitors and the small government control over these operations. In addition given the important costs of having an inventory in storage, Barnes & Noble can prove to be very sensitive towards this segment.

Threat of Substitutes: With a score of 50 Barnes & Noble has an average sensitivity towards this aspect of their business. Given the huge amount of substitutes with no specific differentiations, the company is not sensitive to this aspect.

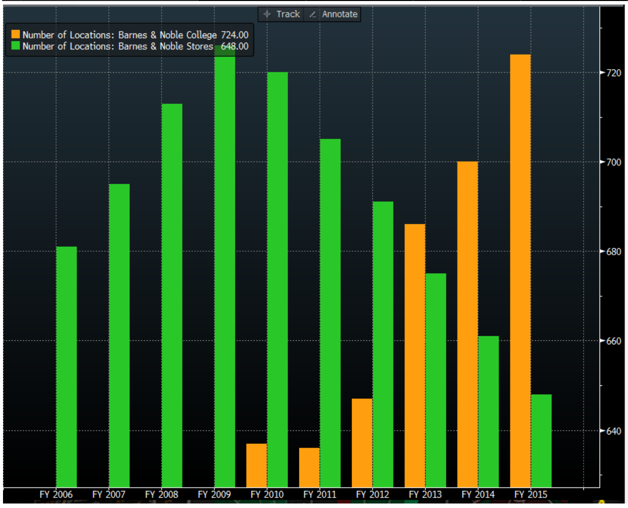
Threat of New Competition: The threat of New Competition is important for Barnes & Noble. With an industry with such low barriers to entry and technological requirements the company can truly suffer if new companies were to enter the market. This phenomenon was illustrated in the past when several companies such as amazon entered the hardcopy and digital book retailing.



Book segment

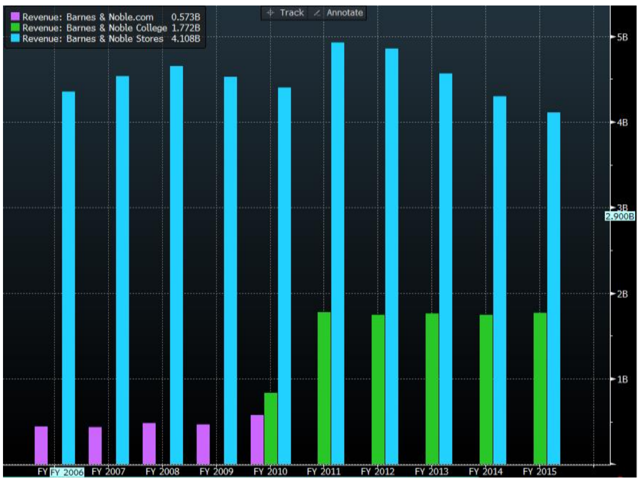
As mentioned earlier Barnes & Noble has encountered issues regarding their hardcopy book retailing segment. To counter this trend the company began concentrating their expansion efforts on their recent Barnes & Noble College Segment which consist in on campus bookstores for text books and other supplies.

In Millions of USD except Per Share	FY 2012		FY 2013		FY 2014		FY 2015	
12 Months Ending	04/28/2012		04/27/2013		05/03/2014		05/02/2015	
Revenue	7,129.2	100.0%	6,839.0	100.0%	6,381.4	100.0%	6,069.5	100.0%
Barnes & Noble Retail	4,852.9	68.1%	4,568.2	66.8%	4,295.1	67.3%	4,108.2	67.7%
Barnes & Noble College	1,743.7	24.5%	1,763.2	25.8%	1,748.0	27.4%	1,772.4	29.2%
NOOK	933.5	13.1%	780.4	11.4%	505.9	7.9%	263.8	4.3%
Elimination	-400.8	-5.6%	-272.9	-4.0%	-167.7	-2.6%	-75.0	-1.2%
Video-Game and Entertainment-S...	–		–		–		–	
Number of Locations	1,338.00	100.0%	1,361.00	100.0%	1,361.00	100.0%	1,372.00	100.0%
Barnes & Noble College	647.00	48.4%	686.00	50.4%	700.00	51.4%	724.00	52.8%
Barnes & Noble Stores	691.00	51.6%	675.00	49.6%	661.00	48.6%	648.00	47.2%



(Source: Bloomberg.)

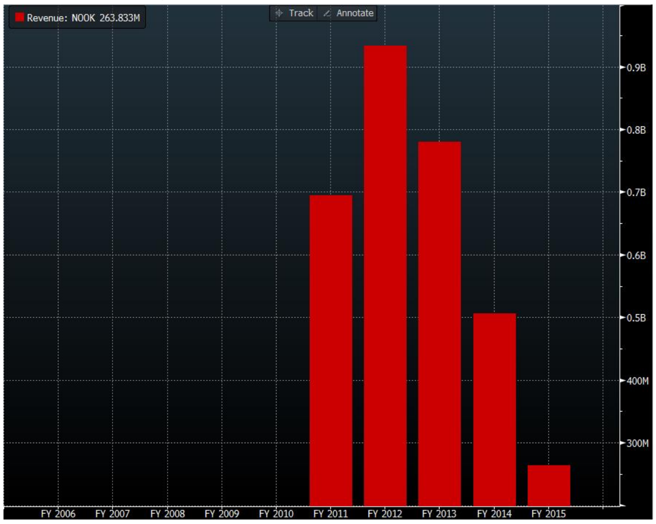
These charts illustrate the strategy launched by Barnes & Noble in order to reverse the downward trend of the firm. Since their first college store in 2009 the company has been increasing their number of location and their revenues generated by these stores. On the other hand when we look closer to the return on investment from these stores we can clearly see that even if the number of stores are increasing the revenue growth does not follow. Given the decrease from all their sources of revenue the company will require to enter a new market in order to survive.



(Source: Bloomberg.)

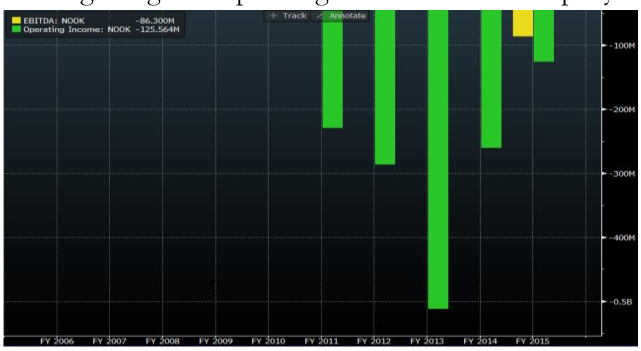
The Nook

The Nook tablet has been a very important product for Barnes & Noble when they first launched on October 2009. This product was supposed to counterbalance the reduction of revenue related to hard copies in the years to follow. After reaching its revenue peak of almost a Billion dollars in 2012 the Nook tablet constantly decreased to reach less than 300 million dollars of revenue in 2015. This downfall is due to a combination of an increasing competition and the weight of the Amazon product (Kindle) in the markets. Barnes & Noble who failed to prove itself as the leader in EBooks is currently suffering the price. The Nook has been included in several partnerships in the last year including a big partnership with Microsoft. This old partnership included the access to eBook platform to Microsoft clients and was ended in 2014 when Barnes & Noble bought back the shares owned by Microsoft.



(Source: Bloomberg.)

In the current situation the company can clearly not rely on the Nook tablet to optimize their revenues in the short or long term. If anything, as a technological product the Nook required research & development expenses that could be invest towards more promising goals. In addition as shown below the Nook tablet is creating a negative operating income for the company.



(Source: Bloomberg.)

Valuation

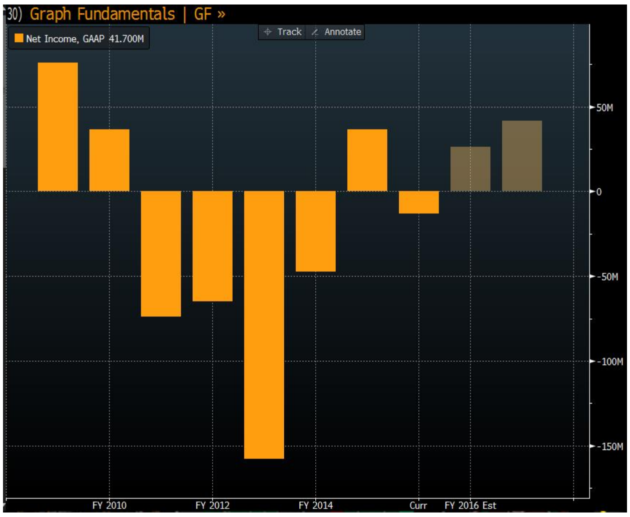
Several variables were to be set before undertaking the valuation of a company on the decline such as Barnes & Noble.

General Assumptions: In order to valuate Barnes & Noble I decided to set the tax rate at 40% and the risk Premium at 6% according to the data for the United-States of America. Even if the company started selling several products in the U.K. its main source of revenue is the United-States of America. The Beta of the company has been set at a 1 year Beta value of 1 which is slightly higher than the base year beta. In order to maintain a conservative vision of the company the cost of debt (kd) has been fixed at the last period data of 1.18%.

Valuation: To perform this valuation I decided to focus on a neutral approach following the current trends of the company. In this case I assumed that the company would follow the same trend they had in the past years without big difference. The SG&A of the company was capitalized at 20% given their management. Furthermore I applied an Additional premium of 2.26% given their potential risk in the years to come. This conservative valuation mode generated a relative decrease in the value of the company in a 1-year time period.

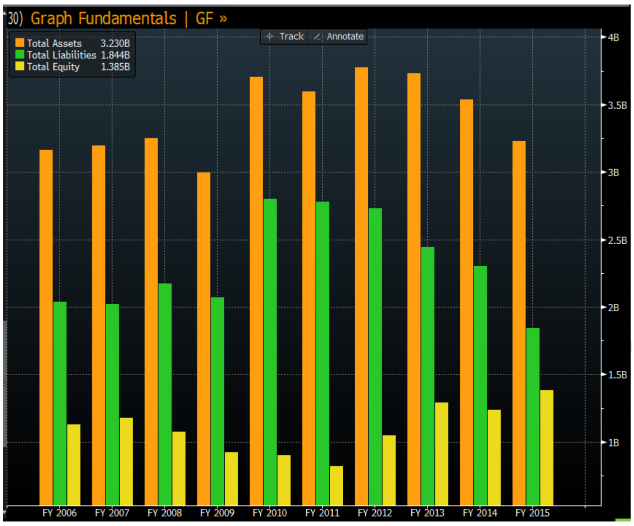
Financials

Income Statement: In the last years the company has suffered several years of negative Net income due to important drops in Sales. Between 2011 and 2015 the sales of the company decreased by 13%. Considering the threat of declining sales Barnes & Noble reduced their Total Operating costs (including COGS) by 6% against a reduction of revenue of 5%. This restructuration triggered an increase of their operating income of 88%. In addition to these cost reduction Barnes & Noble payed 40% less Interest expenses and did not have to pay Restructuring Charges in 2015. The company improved their Net income from $-47.3 million to $36.6 million between 2014 and 2015.



(Source: Bloomberg.)

Balance Sheet: In 2015 Barnes 7 Noble encountered a 9% reduction of their Total Assets. This decrease is mostly due to their Cash & cash Equivalent reduction of 78% in the last year. This decrease is related to two expenses contracted by the company: Reacquisition of preferred membership interest in Nook ($76.2 million) and the Repayment of Junior Seller note ($127.3 million). Furthermore given the reduction of their activities the company decreased their Net Property, Plant & Equipment by 8% in the year. On the Liability and Equity side it can be observed that the company is seeking to balance their capital structure by increasing Equity and Lowering debt. This desire to restructure is mostly related to their higher risk and lower solvency that might bring their interest rates up if the they were to borrow cash.



(Source: Bloomberg.)

Overall Barnes & Noble reduced all the liability lines of their income statement leading a decrease of their Total Liabilities of 20%. On the other hand the company nearly doubled their Equity in the past year with an increase of 81%. Although Barnes & Noble is still repurchasing treasury stocks it has also been benefiting massively from issuing stocks through the Additional Paid In Capital. In 2015 the company has acknowledged an increase of Paid in Capital of 38% and reported an increase of their Total equity of 12%.

Conclusion

Barnes & Noble has suffered from a decreased in revenue in the last years, forcing them to modify their operations and customer focus. This refocus is not efficient enough and the company is failing its expansion in other segments of this saturated market. In addition the company is currently "too expensive" to be considered for an acquisition by any of their competitors. Given this data I recommend a Sell of Barnes & Noble with a 1-year target price of $9.86, with a probability of price increase of 53%. This price target implies a loss of value of 12.35% .

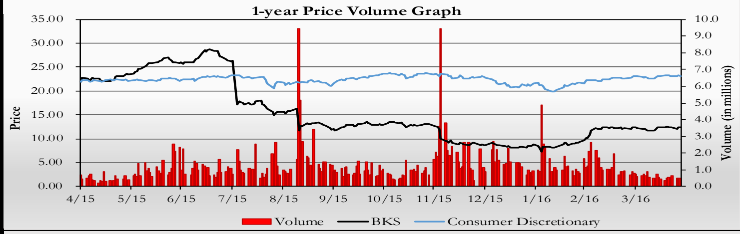
Siena Market Line
1st week of May 2016

Barnes & Noble, Inc. (BKS)

CENTER FOR GLOBAL FINANCIAL STUDIES

NEUTRAL

Analysis by Pierre Gouesclou	Current Price:	$11.75	Intrinsic Value	$10.57	Target 1 year Return: -12.35%
4/30/2016	Divident Yield:	3.8%	Target Price	$9.86	Probability of Price Increase: 53.4%



Description

Barnes & Noble, Inc. retails books, textbooks, magazines, newspapers, and other contents in the United States.

General Information

Sector	Consumer Discretionary
Industry	Specialty Retail
Last Guidance	November 3, 2015
Next earnings date	June 23, 2016
Estimated Country Risk Premium	6.00%
Effective Tax rate	40%
Effective Operating Tax rate	51%

Market Data

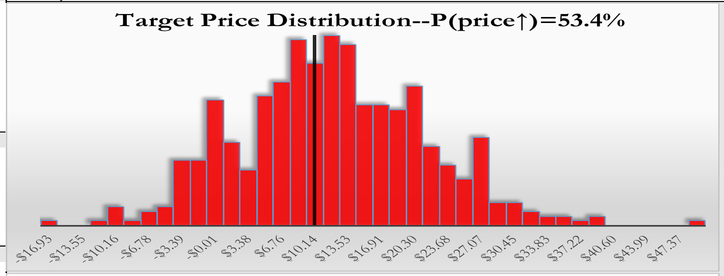
Market Capitalization	$877.61
Daily volume (mil)	0.66
Shares outstanding (mil)	74.69
Diluted shares outstanding (mil)	69.79
% shares held by institutions	78%
% shares held by investments Managers	53%
% shares held by hedge funds	26%
% shares held by insiders	22.80%
Short interest	6.84%
Days to cover short interest	4.73
52 week high	$29.00
52-week low	$7.25
Levered Beta	1.79
Volatility	61.96%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
1/31/2015	-25.15%	-24.44%
5/2/2015	-1.00%	-47.17%
8/1/2015	-3.13%	-46.90%
10/31/2015	N/A	N/A
1/30/2016	-0.70%	-9.30%
Mean	-7.49%	-31.95%
Standard error	5.9%	9.2%

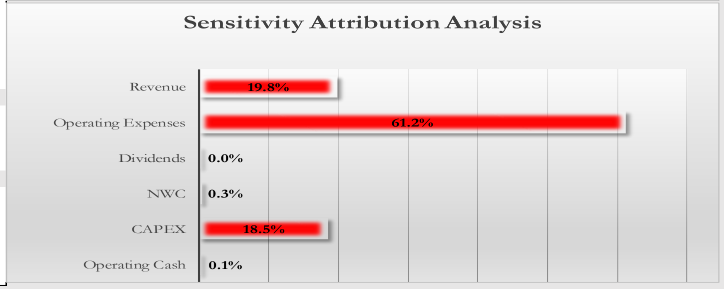
Peers

- News Corporation
- Quad/Graphics, Inc.
- Hubbell Inc.
- R.R. Donnelley & Sons Company
- TEGNA Inc.
- Acuity Brands, Inc.
- Scholastic Corporation
- Whole Foods Market, Inc.

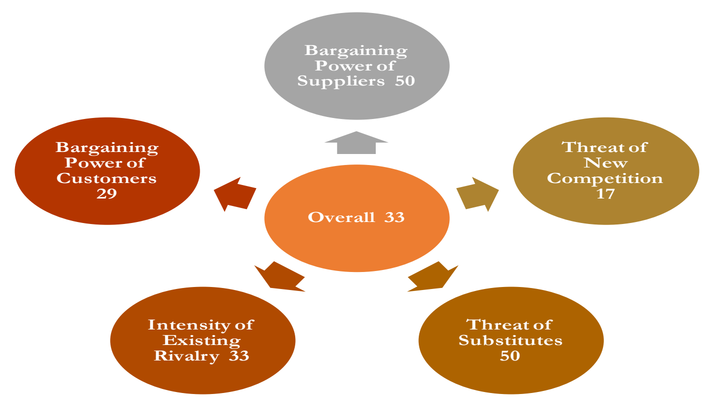


Management	Position	Total compensations growth	Total return to shareholders
Riggio, Leonard	Founder and Executive Chairm	-14.51% per annum over 5y	-11.45% per annum over 5y
Lindstrom, Allen	Chief Financial Officer	-7.48% per annum over 3y	14.06% per annum over 3y
Klipper, Mitchell	Special Advisor	-24.21% per annum over 5y	-11.45% per annum over 5y
Boire, Ronald	Chief Executive Officer and	N/M	N/M
Carey, Jaime	Chief Operating Officer	N/M	0% per annum over 0y
Herpich, Peter	Principal Accounting Officer	N/M	N/M

Profitability	BKS (LTM)	BKS (5 years historical average)	Industry (LTM)
ROIC	3.4%	4.57%	19.87%
NOPAT Margin	4%	5.17%	6.8%
Revenue/Invested Capital	0.84	0.88	2.91
ROE	11.7%	17.59%	23.30%
Adjusted net margin	3%	4.04%	6.4%
Revenue/Adjusted Book Value	3.35	4.36	3.62
Invested Funds	**BKS (LTM)**	**BKS (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	1.0%	2.2%	18%
Estimated Operating Cash/Total Capital	1.0%	1.4%	N/A
Non-cash working Capital/Total Capital	0.0%	1.8%	17%
Invested Capital/Total Capital	102.9%	104.7%	83%
Capital Structure	**BKS (LTM)**	**BKS (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	7.18	3.94	0.22
Cost of Existing Debt	1.18%	3.53%	7.01%
Estimated Cost of new Borrowing	0.97%	2.68%	7.01%
CGFS Risk Rating	AAA	A	A
Unlevered Beta (LTM)	0.64	0.30	0.91
WACC	4.25%	3.69%	9.00%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	26.8%	4.0%	0.79
1/30/2017	-11.6%	5.2%	1.07
1/30/2018	-1.4%	3.8%	0.45
1/30/2019	-1.3%	5.5%	0.94
1/30/2020	-1.2%	5.8%	0.96
1/30/2021	-0.6%	5.6%	0.89
1/30/2022	-0.1%	5.4%	0.86
1/30/2023	0.3%	5.3%	0.82
1/30/2024	0.8%	5.2%	0.79
1/30/2025	1.2%	5.1%	0.80
1/30/2026	1.7%	5.0%	0.75
Continuing Period	2.1%	4.8%	0.72

Period	Invested Capital	Net Claims	Price per share
Base Year	$5,829.17	$5,011.74	$4.60
1/30/2017	$6,443.14	$4,458.29	$10.19
1/30/2018	$6,475.97	$2,535.67	$13.53
1/30/2019	$6,685.85	$2,203.13	$16.30
1/30/2020	$7,143.65	$1,959.07	$19.20
1/30/2021	$6,876.78	$1,631.89	$22.14
1/30/2022	$6,789.61	$1,336.45	$25.07
1/30/2023	$4,961.64	$1,067.10	$27.98
1/30/2024	$4,894.38	$822.73	$30.90
1/30/2025	$4,937.63	$654.32	$33.84
1/30/2026	$4,884.69	$451.18	$36.83
Continuing Period			