

BED BATH & BEYOND INC
Form 10-Q
July 10, 2013
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended June 1, 2013

Commission File Number 0-20214

BED BATH & BEYOND INC.
(Exact name of registrant as specified in its charter)

New York
(State of incorporation)

11-2250488
(IRS Employer Identification No.)

650 Liberty Avenue, Union, New Jersey 07083
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 908/688-0888

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Number of shares outstanding of the issuer's Common Stock:

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Class	Outstanding at June 1, 2013
Common Stock - \$0.01 par value	217,765,600

BED BATH & BEYOND INC. AND SUBSIDIARIES

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BED BATH & BEYOND INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except per share data)
(unaudited)

	June 1, 2013	March 2, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 439,850	\$ 564,971
Short term investment securities	481,804	449,933
Merchandise inventories	2,540,723	2,466,214
Other current assets	412,772	386,367
Total current assets	3,875,149	3,867,485
Long term investment securities	80,868	77,325
Property and equipment, net	1,469,757	1,466,667
Goodwill	486,279	483,518
Other assets	400,595	384,957
Total assets	\$ 6,312,648	\$ 6,279,952
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 977,297	\$ 913,365
Accrued expenses and other current liabilities	367,116	393,094
Merchandise credit and gift card liabilities	262,945	251,481
Current income taxes payable	126,750	77,270
Total current liabilities	1,734,108	1,635,210
Deferred rent and other liabilities	493,674	484,868
Income taxes payable	79,815	80,144
Total liabilities	2,307,597	2,200,222
Shareholders' equity:		
Preferred stock - \$0.01 par value; authorized - 1,000 shares; no shares issued or outstanding	-	-
Common stock - \$0.01 par value; authorized - 900,000 shares; issued 333,958 and 332,696 shares, respectively; outstanding 217,766 and 221,489 shares, respectively	3,340	3,327
Additional paid-in capital	1,589,393	1,540,451
Retained earnings	7,776,102	7,573,612
Treasury stock, at cost; 116,192 and 111,207 shares, respectively	(5,357,776)	(5,033,340)
Accumulated other comprehensive loss	(6,008)	(4,320)

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Total shareholders' equity	4,005,051	4,079,730
Total liabilities and shareholders' equity	\$ 6,312,648	\$ 6,279,952

See accompanying Notes to Consolidated Financial Statements.

BED BATH & BEYOND INC. AND SUBSIDIARIES
 Consolidated Statements of Earnings
 (in thousands, except per share data)
 (unaudited)

	Three Months Ended	
	June 1, 2013	May 26, 2012
Net sales	\$2,612,140	\$ 2,218,292
Cost of sales	1,579,169	1,331,093
Gross profit	1,032,971	887,199
Selling, general and administrative expenses	709,870	573,801
Operating profit	323,101	313,398
Interest expense, net	(225)	(1,056)
Earnings before provision for income taxes	322,876	312,342
Provision for income taxes	120,386	105,506
Net earnings	\$202,490	\$ 206,836
Net earnings per share - Basic	\$0.94	\$ 0.90
Net earnings per share - Diluted	\$0.93	\$ 0.89
Weighted average shares outstanding - Basic	215,451	229,086
Weighted average shares outstanding - Diluted	218,335	232,683

See accompanying Notes to Consolidated Financial Statements.

BED BATH & BEYOND INC. AND SUBSIDIARIES
 Consolidated Statements of Comprehensive Income
 (in thousands, unaudited)

	Three Months Ended	
	June 1, 2013	May 26, 2012
Net earnings	\$202,490	\$ 206,836
Other comprehensive (loss) income:		
Change in temporary impairment of auction rate securities, net of taxes	(222)	398
Pension adjustment, net of taxes	167	23
Currency translation adjustment	(1,633)	(3,023)
Other comprehensive loss	(1,688)	(2,602)
Comprehensive income	\$200,802	\$ 204,234

See accompanying Notes to Consolidated Financial Statements.

BED BATH & BEYOND INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(in thousands, unaudited)

	Three Months Ended	
	June 1, 2013	May 26, 2012
Cash Flows from Operating Activities:		
Net earnings	\$202,490	\$ 206,836
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	52,697	43,410
Stock-based compensation	14,803	12,829
Tax benefit from stock-based compensation	10,213	11,445
Deferred income taxes	(17,229)	(10,558)
Other	(302)	(277)
Increase in assets, net of effect of acquisitions:		
Merchandise inventories	(74,509)	(130,956)
Trading investment securities	(3,911)	(366)
Other current assets	(24,518)	(8,268)
Other assets	(3,898)	(2,190)
Increase (decrease) in liabilities, net of effect of acquisitions:		
Accounts payable	73,497	119,886
Accrued expenses and other current liabilities	(22,018)	(12,346)
Merchandise credit and gift card liabilities	11,464	13,682
Income taxes payable	49,151	27,390
Deferred rent and other liabilities	4,566	1,845
Net cash provided by operating activities	272,496	272,362
Cash Flows from Investing Activities:		
Purchase of held-to-maturity investment securities	(369,268)	(281,130)
Redemption of held-to-maturity investment securities	337,500	421,875
Redemption of available-for-sale investment securities	-	6,475
Capital expenditures	(64,966)	(70,788)
Net cash (used in) provided by investing activities	(96,734)	76,432
Cash Flows from Financing Activities:		
Proceeds from exercise of stock options	22,469	26,140
Excess tax benefit from stock-based compensation	1,084	3,360
Repurchase of common stock, including fees	(324,436)	(306,276)
Net cash used in financing activities	(300,883)	(276,776)
Net (decrease) increase in cash and cash equivalents	(125,121)	72,018

Cash and cash equivalents:

Beginning of period	564,971	1,003,166
End of period	\$439,850	\$ 1,075,184

See accompanying Notes to Consolidated Financial Statements.

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BED BATH & BEYOND INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(unaudited)

1) Basis of Presentation

The accompanying consolidated financial statements have been prepared without audit. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals and elimination of intercompany balances and transactions) necessary to present fairly the financial position of Bed Bath & Beyond Inc. and subsidiaries (the "Company") as of June 1, 2013 and March 2, 2013 and the results of its operations, comprehensive income and cash flows for the three months ended June 1, 2013 and May 26, 2012, respectively.

The accompanying unaudited consolidated financial statements are presented in accordance with the requirements for Form 10-Q and consequently do not include all the disclosures normally required by U.S. generally accepted accounting principles ("GAAP"). Reference should be made to Bed Bath & Beyond Inc.'s Annual Report on Form 10-K for the fiscal year ended March 2, 2013 for additional disclosures, including a summary of the Company's significant accounting policies, and to subsequently filed Forms 8-K.

The Company accounts for its operations as two operating segments: North American Retail and Institutional Sales. The Institutional Sales operating segment, which is comprised of Linen Holdings, does not meet the quantitative thresholds under U.S. generally accepted accounting principles and therefore is not a reportable segment.

2) Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., "the exit price") in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches, including quoted market prices and discounted cash flows. The hierarchy for inputs used in measuring fair value maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Unobservable inputs are inputs that reflect a company's judgment concerning the assumptions that market participants would use in pricing the asset or liability developed based on the best information available under the circumstances. The fair value hierarchy is broken down into three levels based on the reliability of inputs as follows:

- Level 1 – Valuations based on quoted prices in active markets for identical instruments that the Company is able to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2 – Valuations based on quoted prices in active markets for instruments that are similar, or quoted prices in markets that are not active for identical or similar instruments, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

As of June 1, 2013, the Company's financial assets utilizing Level 1 inputs include long term investment securities traded on active securities exchanges. The Company did not have any financial assets utilizing Level 2 inputs. Financial assets utilizing Level 3 inputs included long term investments in auction rate securities consisting of preferred shares of closed end municipal bond funds (See "Investment Securities," Note 4).

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the Company's degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an asset or liability must be classified in its entirety based on the lowest level of input that is significant to the measurement of fair value.

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Valuation techniques used by the Company must be consistent with at least one of the three possible approaches: the market approach, income approach and/or cost approach. The Company's Level 1 valuations are based on the market approach and consist primarily of quoted prices for identical items on active securities exchanges. The Company's Level 3 valuations of auction rate securities, which had temporary valuation adjustments of approximately \$2.4 million and \$2.0 million as of June 1, 2013 and March 2, 2013, respectively, are based on the income approach, specifically, discounted cash flow analyses which utilize significant inputs based on the Company's estimates and assumptions. As of June 1, 2013, the inputs used in the Company's discounted cash flow analysis included current coupon rates ranging from 0.20% to 0.25%, an estimated redemption period of 5 years and a discount rate of 1.21%. The discount rate was based on market rates for risk-free tax-exempt securities, as adjusted for a risk premium to reflect the lack of liquidity of these investments. Assuming a higher discount rate, a longer estimated redemption period and lower coupon rates would result in a lower fair market value. Conversely, assuming a lower discount rate, a shorter estimated redemption period and higher coupon rates would result in a higher fair market value.

The following tables present the valuation of the Company's financial assets as of June 1, 2013 and March 2, 2013, measured at fair value on a recurring basis by input level:

(in millions)	As of June 1, 2013		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)	Total
Long term - available-for-sale securities:			
Auction rate securities	\$-	\$ 48.6	\$48.6
Long term - trading securities:			
Nonqualified deferred compensation plan assets	32.2	-	32.2
Total	\$32.2	\$ 48.6	\$80.8

(in millions)	As of March 2, 2013		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)	Total
Long term - available-for-sale securities:			
Auction rate securities	\$-	\$ 49.0	\$49.0
Long term - trading securities:			
Nonqualified deferred compensation plan assets	28.3	-	28.3
Total	\$28.3	\$ 49.0	\$77.3

The following table presents the changes in the Company's financial assets that are measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

(in millions) Auction Rate

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	Securities
Balance on March 2, 2013, net of temporary valuation adjustment	\$ 49.0
Change in temporary valuation adjustment included in accumulated other comprehensive loss	(0.4)
Redemptions at par	-
Balance on June 1, 2013, net of temporary valuation adjustment	\$ 48.6

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Fair Value of Financial Instruments

The Company's financial instruments include cash and cash equivalents, investment securities, accounts payable and certain other liabilities. The Company's investment securities consist primarily of U.S. Treasury securities, which are stated at amortized cost, and auction rate securities, which are stated at their approximate fair value. The book value of all financial instruments is representative of their fair values.

3) Cash and Cash Equivalents

Included in cash and cash equivalents are credit and debit card receivables from banks, which typically settle within five business days, of \$88.1 million and \$87.8 million as of June 1, 2013 and March 2, 2013, respectively.

4) Investment Securities

The Company's investment securities as of June 1, 2013 and March 2, 2013 are as follows:

(in millions)	June 1, 2013	March 2, 2013
Available-for-sale securities:		
Long term	\$48.6	\$49.0
Trading securities:		
Long term	32.2	28.3
Held-to-maturity securities:		
Short term	481.8	449.9
Total investment securities	\$562.6	\$527.2

Auction Rate Securities

As of June 1, 2013 and March 2, 2013, the Company's available-for-sale investment securities represented approximately \$51.0 million par value of auction rate securities, less temporary valuation adjustments of approximately \$2.4 million and \$2.0 million, respectively. Since these valuation adjustments are deemed to be temporary, they are recorded in accumulated other comprehensive loss, net of a related tax benefit, and did not affect the Company's net earnings. These securities at par are invested in preferred shares of closed end municipal bond funds, which are required, pursuant to the Investment Company Act of 1940, to maintain minimum asset coverage ratios of 200%. All of these available-for-sale investments carried triple-A credit ratings from one or more of the major credit rating agencies as of June 1, 2013 and March 2, 2013, and none of them are mortgage-backed debt obligations. As of June 1, 2013 and March 2, 2013, the Company's available-for-sale investments have been in a continuous unrealized loss position for 12 months or more, however, the Company believes that the unrealized losses are temporary and reflect the investments' current lack of liquidity. Due to their lack of liquidity, the Company classified approximately \$48.6 million and \$49.0 million of these investments as long term investment securities at June 1, 2013 and March 2, 2013, respectively.

U.S. Treasury Securities

As of June 1, 2013 and March 2, 2013, the Company's short term held-to-maturity securities included approximately \$481.8 million and approximately \$449.9 million, respectively, of U.S. Treasury Bills with remaining maturities of less than one year. These securities are stated at their amortized cost which approximates fair value, which is based on quoted prices in active markets for identical instruments (i.e., Level 1 valuation).

Long Term Trading Investment Securities

The Company's long term trading investment securities, which are provided as investment options to the participants of the nonqualified deferred compensation plan, are stated at fair market value. The values of these trading investment securities included in the table above are approximately \$32.2 million and \$28.3 million as of June 1, 2013 and March 2, 2013, respectively.

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5) Property and Equipment

As of June 1, 2013 and March 2, 2013, included in property and equipment, net is accumulated depreciation and amortization of approximately \$1.9 billion and \$1.8 billion, respectively.

6) Stock-Based Compensation

The Company measures all employee stock-based compensation awards using a fair value method and records such expense, net of estimated forfeitures, in its consolidated financial statements. Currently, the Company's stock-based compensation relates to restricted stock awards and stock options. The Company's restricted stock awards are considered nonvested share awards.

Stock-based compensation expense for the three months ended June 1, 2013 and May 26, 2012 was approximately \$14.8 million (\$9.3 million after tax or \$0.04 per diluted share) and approximately \$12.8 million (\$8.5 million after tax or \$0.04 per diluted share), respectively. In addition, the amount of stock-based compensation cost capitalized for the three months ended June 1, 2013 and May 26, 2012 was approximately \$0.4 million and \$0.3 million, respectively.

Incentive Compensation Plans

The Company currently grants awards under the Bed Bath & Beyond 2012 Incentive Compensation Plan (the "2012 Plan"), which amended and restated the Bed Bath & Beyond 2004 Incentive Compensation Plan (the "2004 Plan"). The 2012 Plan includes an aggregate of 43.2 million common shares authorized for issuance. Outstanding awards that were covered by the 2004 Plan continue to be in effect under the 2012 Plan.

The 2012 Plan is a flexible compensation plan that enables the Company to offer incentive compensation through stock options (whether nonqualified stock options or incentive stock options), restricted stock awards, stock appreciation rights, performance awards and other stock based awards, including cash awards. Under the 2012 Plan, grants are determined by the Compensation Committee for those awards granted to executive officers and by an appropriate committee for all other awards granted. Awards of stock options and restricted stock generally vest in five equal annual installments beginning one to three years from the date of grant.

The Company generally issues new shares for stock option exercises and restricted stock awards. As of June 1, 2013, unrecognized compensation expense related to the unvested portion of the Company's stock options and restricted stock awards was \$33.6 million and \$153.2 million, respectively, which is expected to be recognized over a weighted average period of 3.4 years and 4.1 years, respectively.

Stock Options

Stock option grants are issued at fair market value on the date of grant and generally become exercisable in either three or five equal annual installments beginning one year from the date of grant for options issued since May 10, 2010, and beginning one to three years from the date of grant for options issued prior to May 10, 2010, in each case, subject, in general to the recipient remaining in the Company's employ or service on specified vesting dates. Option grants expire eight years after the date of grant for stock options issued since May 10, 2004, and expire ten years after the date of grant for stock options issued prior to May 10, 2004. All option grants are nonqualified.

The fair value of the stock options granted was estimated on the date of the grant using a Black-Scholes option-pricing model that uses the assumptions noted in the following table.

Black-Scholes Valuation Assumptions (1)	Three Months Ended			
	June 1, 2013		May 26, 2012	
Weighted Average Expected Life (in years) (2)	6.6		6.5	
Weighted Average Expected Volatility (3)	29.27	%	31.06	%
Weighted Average Risk Free Interest Rates (4)	1.11	%	1.14	%
Expected Dividend Yield	-		-	

(1) Forfeitures are estimated based on historical experience.

(2) The expected life of stock options is estimated based on historical experience.

(3) Expected volatility is based on the average of historical and implied volatility. The historical volatility is determined by observing actual prices of the Company's stock over a period commensurate with the expected life of the awards. The implied volatility represents the implied volatility of the Company's call options, which are actively traded on multiple exchanges, had remaining maturities in excess of twelve months, had market prices close to the exercise prices of the employee stock options and were measured on the stock option grant date.

(4) Based on the U.S. Treasury constant maturity interest rate whose term is consistent with the expected life of the stock options.

Changes in the Company's stock options for the three months ended June 1, 2013 were as follows:

(Shares in thousands)	Number of Stock Options	Weighted Average Exercise Price
Options outstanding, beginning of period	5,006	\$ 42.32
Granted	563	69.78
Exercised	(577)	38.92
Forfeited or expired	(2)	37.79
Options outstanding, end of period	4,990	\$ 45.81
Options exercisable, end of period	3,195	\$ 39.38

The weighted average fair value for the stock options granted during the first three months of fiscal 2013 and 2012 was \$22.28 and \$23.06, respectively. The weighted average remaining contractual term and the aggregate intrinsic value for options outstanding as of June 1, 2013 was 4.1 years and \$113.4 million, respectively. The weighted average remaining contractual term and the aggregate intrinsic value for options exercisable as of June 1, 2013 was 2.9 years and \$92.3 million, respectively. The total intrinsic value for stock options exercised during the first three months of fiscal 2013 and 2012 was \$15.5 million and \$21.8 million, respectively.

Net cash proceeds from the exercise of stock options for the first three months of fiscal 2013 were \$22.5 million and the net associated income tax benefit was \$11.3 million.

Restricted Stock

Restricted stock awards are issued and measured at fair market value on the date of grant and generally become vested in five equal annual installments beginning one to three years from the date of grant, subject, in general, to the recipient remaining in the Company's employ or service on specified vesting dates. Vesting of restricted stock awarded to certain of the Company's executives is dependent on the Company's achievement of a performance-based test for the fiscal year of grant and, assuming achievement of the performance-based test, time vesting, subject, in general, to the executive remaining in the Company's employ on specified vesting dates. The Company recognizes compensation

expense related to these awards based on the assumption that the performance-based test will be achieved. Vesting of restricted stock awarded to the Company's other employees is based solely on time vesting.

Changes in the Company's restricted stock for the three months ended June 1, 2013 were as follows:

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(Shares in thousands)	Number of Restricted Shares	Weighted Average Grant-Date Fair Value
Unvested restricted stock, beginning of period	4,063	\$ 45.98
Granted	706	69.54
Vested	(836)	38.32
Forfeited		