

Best Buy profit below view on expenses, shares off

Reuters, Tuesday September 16 2008

By Karen Jacobs

ATLANTA, Sept 16 (Reuters) - Consumer electronics retailer Best Buy Co posted a steeper-than-expected drop in quarterly profit as it spent more than planned to bolster its stores, sending shares down 5 percent.

Best Buy has been spending to improve its stores and lay the groundwork for expansion, but some investors are concerned about the pace of investment as the U.S. economy weakens.

"Over the long term, management is doing the right things" to drive growth, said Alan Lancz, president of Alan B. Lancz & Associates, a Toledo, Ohio, investment advisory firm.

But "as the economy slows down, the most profitable part of their business will slow down," Lancz added. "There's a lot of headwinds for what they're going to be facing into the holiday season."

Best Buy's net earnings fell 19 percent to \$202 million, or 48 cents a diluted share, for the second quarter that ended Aug. 30, compared with \$250 million, or 55 cents a share, a year earlier.

Analysts had expected 57 cents a share, according to Reuters Estimates.

Best Buy's selling, general and administrative expenses rose 17 percent in the quarter as it added staff to support the roll-out of Best Buy Mobile shops in its stores. The company has also added musical instruments and Apple Inc computer departments to some stores.

"Best Buy's error is being too aggressive, and we do expect the company to dial back expenses, but this lack of expense discipline/control is a periodic issue," Sanford Bernstein analyst Colin McGranahan said in a research note. Chief Executive Brad Anderson acknowledged that the company has "some work to do in terms of managing our expenses amid a challenging macroeconomic environment."

Best Buy said it had also boosted staffing to help sales during during the back-to-school shopping period.

The company said it planned to cut some overhead and travel expenses in the second half but would not scale back growth investments.

IMPROVED REVENUE

Quarterly revenue rose 12 percent to \$9.8 billion, better than the \$9.67 billion analysts had expected. Sales at U.S. stores open at least 14 months rose 5.3 percent, while total domestic sales rose 12 percent.

International revenue rose 10 percent, but comparable-store sales declined 1 percent.

The Minneapolis chain faces a slowing spending environment as rising food costs and a U.S. housing slump pressure consumers. But it is faring better than rival Circuit City Stores Inc, which is exploring strategic options.

Best Buy has stepped up its offerings in mainstay categories such as cellphones while also moving into areas outside traditional consumer electronics. For example, on Monday, Best Buy said it would buy digital music service Napster Inc for \$121 million to reach new customers.

Earlier this year, the company paid about \$2 billion to create a joint venture with Britain's Carphone Warehouse Group Plc that will open Best Buy stores in Europe.

Investment income came to \$9 million in the quarter, down from \$22 million a year earlier.

Best Buy backed its previous full-year forecast calling for profit of \$3.25 a share to \$3.40 a share. Analysts have expected \$3.29 a share, according to Reuters Estimates.

Best Buy shares fell \$2.38, or 5.5 percent, to \$41.32 on the New York Stock Exchange, while Circuit City was up 4 cents, or 2.5 percent, to \$1.67. Best Buy shares have fallen 22 percent this year, while Circuit City is down 60 percent. (Reporting by Karen Jacobs, editing by Gerald E. McCormick)