Net Takeaways

Stan Johnson Co.

Best Buy's New Real Estate Strategy is a Message from the Future

"We are building all of our experiences around meeting these needs as we move from being a big box retailer with a strong omni-channel presence to an omni-channel retailer with a large store footprint for support and fulfillment."

The above statement was made by CEO Corie Barry in Best Buy's most recent quarterly earnings call on Thursday, February 25th. It is perhaps a penultimate synopsis of the broader fusion of online and bricks and mortar that has been underway for the past five years. In one fell swoop, the CEO effectively severed Best Buy from its core foundation as bricks and mortar retailer and launched it into omni-channel status.

The statement was the initial salvo of a broader and far-ranging strategy articulated by Best Buy to reframe the way in which it interacts and utilizes its real estate. The strategy should receive close attention and scrutiny from the real estate investment community. Best Buy is not, like a litany of other retailers, struggling in the classical definition of the word. As we documented last year, the company has fared well following the bankruptcies of its competitors Circuit City and HH Gregg and its pivot to compete with Amazon via fulfillment and customer service. In 2020, the company made $816 million, and is currently valued at roughly $26 billion. Thus, the company's decision to focus intensively on cost savings and flexibility in real estate cannot be ascribed to a simple need to realize cost savings.

In the earnings call, Best Buy outlined the following regarding its retail real estate boxes:

"Plan to reduce the sales floor square footage and install warehouse grade packaging stations"

"Higher thresholds on renewing leases as we evaluate the role each store plays in its market"

"We have closed approximately 20 large format stores each of the past two years, and expect to close a higher number this year"

"We have been reducing the length of our average lease term, which will continue to provide us flexibility"

"During Q4, we used 340 stores or roughly 35% of our store locations to handle about 70% of our total ship-from-store units. We believe that we can achieve similar results consolidating volume, using a smaller group of stores as hubs over time"

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The statements by Best Buy represent a reframing of retail real estate in the new hierarchy of the transformation to an "omni-channel retailer." Real estate formerly was the linchpin that singularly defined the customer experience and created revenue; however, with 43% of the company's sales coming online, the company is moving toward a new paradigm in which expenses and "occupancy" costs need to be viewed as a tradeoff between the physical and online environment.

The strategy shift needs to be understood with a new calculus, which weighs retailer revenue generation (and associated costs) between online and physical environments. With almost half of all sales coming online, stores need to be viewed in a broader context of fulfillment efficiency in a national network. With 35% of the stores covering 70% of all online orders, there is a minority number of stores benefiting from the shift to omni-channel.

Real estate market participants would be wise to view Best Buy's comments as indicative of broader advance trends that will be underway over the next five years. The changes necessitate a need to understand how locations are serving the broader sales ecosystem of retailers, which will define how the locations preserve over time, and the security of tenancy.

Sources:
- Best Buy Co., Inc. (BBY) CEO Corie Barry on Q4 2021 Results - Earnings Call Transcript
- Best Buy Reports Fourth Quarter Results

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BJ Feller
Managing Director & Partner
bfeller@stanjohnsonco.com

Isaiah Harf
Regional Director & Partner
iharf@stanjohnsonco.com

Pat Weibel
Director
pw@stanjohnsonco.com

Andy Gatchell
Associate Director
agatchell@stanjohnsonco.com

Blaise Bennett
Associate Director
bbennett@stanjohnsonco.com

Mark Lovering
Associate Director
mlovering@stanjohnsonco.com

Christian Tremblay
Associate Director
ctremblay@stanjohnsonco.com

Jake Hamilton
Associate
jhamilton@stanjohnsonco.com

Stan Johnson Company
303 East Wacker Drive | Suite 1111
Chicago, IL 60601

Stan Johnson Company
11601 Wilshire Boulevard | Fifth Floor
Los Angeles, CA 90025

Stan Johnson Company
440 Stevens Avenue | Suite 200
Solana Beach, CA 92075

stanjohnsonco.com