



Big Lots, Inc. Valuation

ACC 712: Section 3

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Business Strategy

Macroeconomy

Gross Domestic Product (GDP), Consumer Spending, Consumer Purchase Index (CPI) and Retail Sales are economic indicators that most influence the performance of Closeout Retail as an industry group, and more specifically retailer Big Lots, Inc. (BLI) as an industry operator. Real GDP increased at an annual rate of 4.1% in the fourth quarter of 2003 due, in part, to increase in personal consumption expenditures. Disposable income increased 0.4% and personal consumption expenditures increased 0.2% in February of 2004 compared to the previous month.¹ Retail and food services sales for February 2004 increased at an annual rate of 7.9%.² CPI as a measure of inflation remains relatively flat at 2.0%, suggesting inflation is not an immediate concern. Each indicator points to near term economic growth (**Appendix A**).

Industry

Closeout retailers purchase excess inventory at steep discounts from production overruns, discontinued products or returns, and offer merchandise at significantly lower prices than traditional retailers. In the Thomson First Call Retail Index, discount retailers have consistently generated the strongest monthly same store sales growth, and exceeded analyst expectations more often than any other retail segment.³ But growth has slowed over the past 10 years due to a large number of competitors and pressures to cut operating expenses. Additional industry trends include a decrease in the purchase of seasonal products, an emerging higher income customer segment for some discounters, and an emphasis on just-in-time inventory technology.⁴

Company

Big Lots is the country's largest broadline closeout retailer with over 1,400 store locations, offering private label and brand name merchandise ranging from furniture to foods to seasonal products. Big Lots has adopted a low cost strategy, offering products priced 20 to 40 percent below most discount retailers according to company estimates. As a result, it has traded low profit margins (1.9% in 2003) for high asset turnover (2.44 in 2003).⁵ Big Lots' strategy for success includes timing the acquisition of low cost merchandise, strong supplier relationships and improving the shopping experience through store remodeling to increase the number and dollar value of customer transactions (both increased by 1.7% in 2003). However, it has several key risk factors including low brand awareness, weather conditions that affect seasonal products, and numerous competitors in the discount retail category including Dollar Tree, Dollar General, 99 Cent Only Stores, and Family Dollar Stores, that compete for customers across Big Lots' diverse product lines. Although Wal-Mart (WMT) doesn't compete directly in BLI's space, BLI must look to in the broader discount retail category for efficiency benchmarks. In addition, Big Lots purchases roughly 25% of its products from overseas suppliers, making it subject to exchange rate risk, increased import duties, and labor strikes.⁶ To address the issue of brand recognition, Big Lots began its conversion of all stores (under the names Odd Lots, Mac Frugal's, and Pic 'N' Save) to a single national brand name in 2002, and recently embarked on a national, versus regional, television advertising campaign. With its diverse product offerings, Big Lots fills a niche somewhere between its dollar-only competitors and Target or Wal-Mart. While it has struggled in the past, Big Lots is taking steps to achieve sustainable earnings by focusing on branding and store remodeling. Big Lots' ROE will exceed its cost of capital if these steps are successful in differentiating the shopping experience for its customers.

¹ Bureau of Economic Analysis

² The Census Bureau of the Department of Commerce

³ Thomson Financial Analyst Report, February 2004.

⁴ Standard & Poor's

⁵ Profit Margin = Net income/Sales = 81,175/4,174,383

Asset Turnover = Sales/Average Total Assets = 4,174,383/[(1,784,688+1,641,761)/2]

⁶ Standard & Poor's

Accounting Analysis

Our analysis has uncovered the following accounting distortions, which we have restated together with actuals as provided by Big Lot's issued financial statements to reflect what we believe to be the true underlying business reality of the company. Our forecasts, discussed later, incorporate these pro-forma restatements.

Income Statement

- *Effective Tax Rate:* In 2003 the tax rate was 20.9%. In our forecasts we use a tax rate of 39.5% since the effective tax rate is expected to be 39.5% on an ongoing basis. In 2001, when BLI sold KB Toys to Havens Corners Corporation (HCC), BLI received a ten year note which it recorded on the books at a fair value of \$13 million. When KB Toys filed for bankruptcy in January 2004, BLI took a \$9.6 million net charge based on its valuation of the Note. Based on this charge and the reversal of accrued federal taxes, BLI's effective tax rate in 2003 decreased to 20.9%.
- *Leases:* Big Lots holds operating leases on their stores. The accounting accurately reflects this as a selling and administrative expense, so no change was required.
- *Discontinued operations:* In 2003, Big Lots incurred a loss of \$9.7 million due to the KB Toys write off. This is considered a one-time loss and the ensuing forecast assumes no repeat occurrence.
- *SG&A and Cost of Good Sold:* As detailed below, BLI classifies certain costs (e.g., depreciation and costs related to distribution networks) as selling and administrative whereas most peers classify them as cost of goods sold. The result is that BLI's COGS is understated and SG&A is overstated in comparison to its peers (see **Exhibit 1** below). This recording method does not affect overall income, therefore numbers have *not* been altered in the financials. However, we discuss the effect of this difference on gross margins in the Financial Analysis section.

Exhibit 1: SG&A/Sales Comparison (Current)

	SG&A / Sales			COGS / Sales		
	2003	2002	2001	2003	2002	2001
Big Lots (BLI)	38.71%	38.39%	39.86%	55.97%	55.71%	58.93%
Ninety Nine Cents (NDN)	27.20%	24.98%	24.48%	59.92%	59.86%	60.60%
Dollar General (DG)	21.78%	21.25%	21.34%	68.41%	69.52%	69.33%
Dollar Tree (DLTR)	N/A	25.50%	23.06%	N/A	60.52%	63.97%
Family Dollar Stores (FDO)	25.57%	25.33%	25.31%	64.37%	64.62%	64.70%
Averages:	BLI	38.99%		BLI	56.87%	
	Peers	24.16%		Peers	64.17%	

In addition note that BLI incurred non-recurring charges to SG&A due to settlement of a California lawsuit, write-off of a KB warrant and HCC Note, placing upward pressure on the measure.

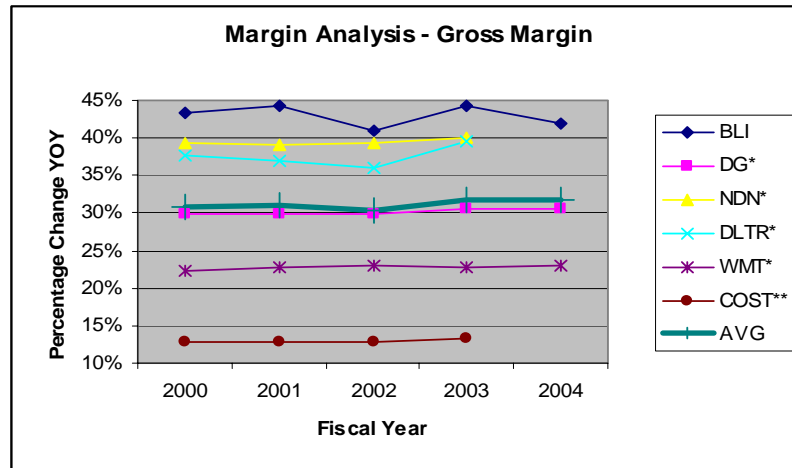
Balance Sheet

- *Pensions:* BLI's pension assets are under-funded by \$11.5 million. Assuming a discount rate of 6.8% and a return of 8.5% on the pension assets, BLI will need to fund the pension plan with \$256,000 annually over the next ten years in order to fully fund the plan. Accordingly, we have applied this increase to SG&A in our forecasts to more accurately reflect costs (See **Appendix B** for Pension Calculations, and **Appendix C** for the impact on SG&A).

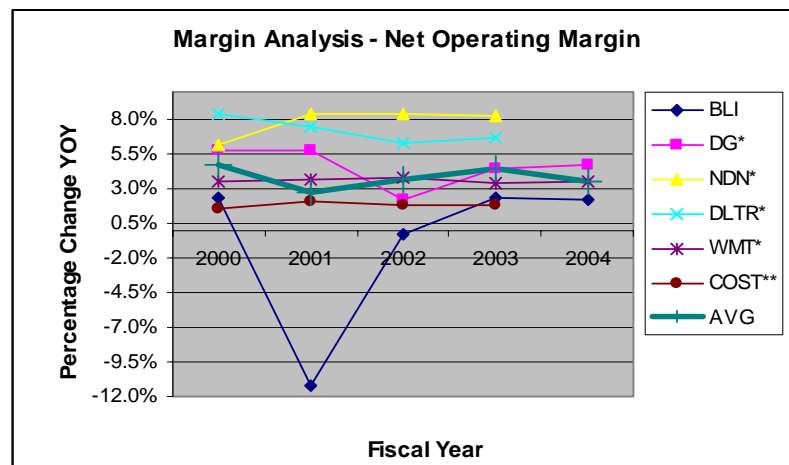
Financial Analysis⁷

Profitability & Growth

Occupying a unique niche in specialty retailing, BLI continues to consistently earn among the highest gross margins in its peer group, 42% in 2003 versus an industry average of 32%. This points to BLI's proclaimed competitive advantage; strong relationships with vendors, and its ability to warehouse stock purchased at heavy discounts off-season. However, gross margins that show a workable business model are accompanied by low operating margins, which indicates that BLI is beset by strategic and execution mishaps. BLI's net operating margin, 2.3% in 2003 underperforms a 3.61% peer group average.



Where BLI postures the lowest COGS/Sales ratio among its peers, it is immediately discounted given a high percentage of SG&A/Sales, as indicated by a 3.12% EBITDA margin versus an industry level of 9%. BLI admits to recording certain expenses within SG&A, to which its peer group would otherwise consider expenses under COGS. Although this doesn't have an impact on profit margins, it does affect gross margin and net operating margin comparables. The volatility in EBITDA margin is attributable to significant variation in sales growth, as COGS and SG&A have been relatively constant. Thus, we suspect that BLI has not historically been able to benefit from economies of scale.



However, trends indicate that BLI's financial performance has powerfully rebounded from a five year low in 2001. The negative 15% difference between net operating margin and net operating margin before non-recurring items is directly attributable to the write-down of assets associated with the losing proposition KB Toys. Return on equity (ROE) to investors has hovered at 8% in 2002 and 2003, low by industry standards (17%) and significantly more volatile, but continuing to improve over recent lows of -34% in

⁷ **Tickers** – Dollar Tree (DLTR), Dollar General (DG), 99 Cent Only Stores (NDN), Wal-Mart (WMT), Costco (COST), Family Dollar Stores (FDO) and a peer group average (AVG)

* DG, NDN, DLTR and WMT all follow a calendar fiscal year (BLI follows a February to January fiscal year cycle)

** Costco follows a September to August fiscal year

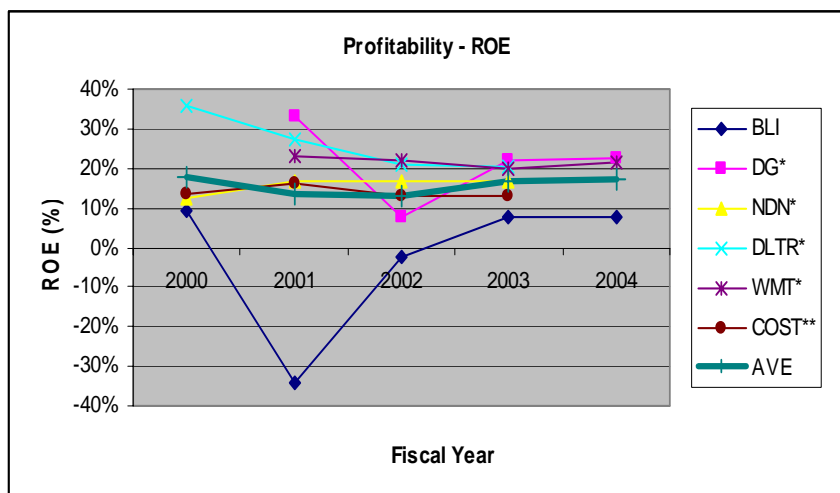
2001 and -2% in 2002. Further analysis of ROE using the Advanced Dupont Model (**Exhibit 2**) paints a dismal picture compared to industry players, but promising for Big Lots as strategy and time work to improve fundamentals.

Exhibit 2: Advanced DuPont

	Net Operating Margin	Net Oper. Asset Turnover	RNOA	Net Borrowing Costs	Spread	Leverage	ROE
BLI	2.3%	3.56	8.0%	12.7%	-4.7%	9.5%	7.6%
Peer Average	3.6%	3.72	13.2%	6.9%	11.8%	31%	17.3%

FY 2003 – Source: Media General

BLI's RNOA of 8% indicates a comparatively weak operating performance compared to the industry average. A high variation in RNOA (a low of -27.2% in 1999 to a high of 8% in 2003), and less variation but increasing net borrowing costs are the root causes of significant variation but improving performance in spread. The significant range in each of the components of ROE explains the negative,



but significantly improved, ROE from 1999 to 2002. RNOA for BLI does not exceed net borrowing costs of 12.7%. This is an immediate indicator that ROE will not exceed RNOA and that common equity holders have received little if any share of net operating income. BLI includes substantially less financial leverage as a component of its capital structure compared to industry standards, also an indicator of a less competitive ROE. This is both a blessing and a hindrance, as risk to shareholders is significantly reduced given the companies marginal use of leverage. Should the company perform given its potential, we can anticipate additional leverage to magnify gains.

Valuation Ratios: P/E, P/B and PEG

The 2003 BLI PEG ratio of 1.01 implies that the company is valued at par by the market. The PEG ratio with Big Lots' P/E multiple of 19.11, the lowest in its peer group, yields an intrinsic growth rate of 19.11%. We believe that the company's strategy and resultant sales growth of 7.9% for 2003, and 12% in 2002 support an upward growth trend over previous periods. A year over year decline in sales growth of 4.8% is still a vast improvement when compared to BLI's five year CAGR of -0.9% (See **Exhibit 3**). However, the -0.9% is mostly attributable to the KB Toys write-off. Increased efficiencies and an increase in forecasted sales imply substantial increases in earnings growth rates.

Exhibit 3: Historic Sales Growth

Sales CAGR ³	10-year	5-year	1-year
Big Lots (BLI)	15.3	-0.9	12.7
Ninety Nine Cents (NDN)	N/A	25.3	23.5
Dollar General (DG)	20.8	18.4	14.6

Dollar Tree (DLTR)	N/A	29.7	17.2
Family Dollar Stores (FDO)	13.6	15.8	13.6

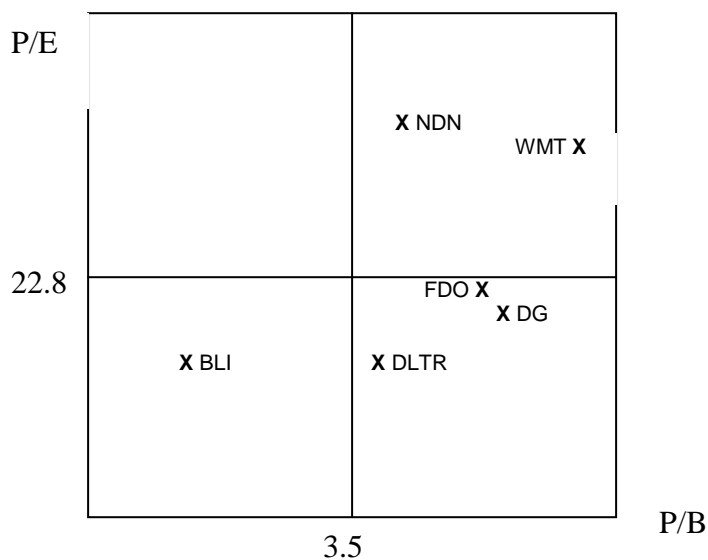
³ S&P Netadvantage 2002

BLI's Price-to-book ratio of 1.7 in 2003 is again the lowest in its peer group, significantly below the average of 3.5 (See **Exhibit 4** for peer group). Although 2001 profits declined as a result of a \$478 million extraordinary charge, profitability for later years declined due to a disproportionate increase in SG&A and COGS expenses in 2002 and 2003. 99 Cents Stores (NDN) has been more profitable than BLI for several years including 2003, reflected in its higher P/B ratio.

Exhibit 4: Peer Group (Morningstar 4/8/2004)		
Company	P/B	P/E
BLI	1.7	19.11
NDN	3.7	31.18
DLTR	3.6	19.6
DG	4.3	21.3
FDO	4.2	22.8
WMT	6	28.77
Average without WMT	3.5	22.79
Average with WMT	3.9	23.79

BLI has not performed in line with expectations that consumers look for value during a down economy. During the recession years 2000-2003, BLI's performance has been affected by the competitive space and its own business management practices. Big Lots has lagged its peers in sales and earnings growth. While NDN leads the group with growth rates of about 25%, BLI brings up the rear with 12.7% in 2002 and 7.9% in 2003. Past earnings growth also reflects a low sales growth and little or no improvement in overall costs. **Exhibit 5** indicates BLI is currently a dog stock within its peer category, with Wal-Mart as the most profitable in the category, and NDN having the highest growth potential.

Exhibit 5: Valuation Ratio Map⁸



Historical performance as understood through our process of financial analysis can now be used along with future industry and market data and associated trends to develop a forecast for BLI.

⁸ P/E and P/B averages derived using companies in direct peer group

Forecasting

Ten-year forecasted financial statements for Big Lots are based on the following assumptions:

Item	Current	2005 Forecast	Terminal Forecast	Reason
Income Statement Assumptions				
Sales Growth	7.9%	13.5%	2.5%	<ul style="list-style-type: none"> ➤ (1+forecast comp)(1+growth in # stores) -1 c = 6.7%, s = 6.42% ➤ Remodeled stores ➤ Better merchandising ➤ New advertisement campaign ➤ Company adding experienced professionals to team
Cost of Goods Sold/Sales	58.2%	56.5%	56.5%	Based on BLI's 3-year average
R&D/Sales	0.0%	0.0%	0.0%	Company has no R&D Expenses
SG&A/Sales	38.7%	38.0%	37.0%	<ul style="list-style-type: none"> ➤ Based on 3-year average as well as accounting for provision for pension related outflows ➤ Reversed recent rise in SG&A due to KB warrant and HCC note and Settlement of California class action law suits (combined 0.45%) ➤ In the long term we bring operating margin in line with industry average of 37% ➤ Increased efficiencies due to new inventory technology implementation ➤ New distribution centers set up close to stores thereby reducing costs ➤ Brand consolidation resulting in increase in overall efficiencies ➤ Spreading fixed costs over increased sales
Dep&Amort/Avg PP&E and Intang.	0.0%	13.2%	13.2%	<ul style="list-style-type: none"> ➤ Revert back to 3-year average since company is currently undertaking remodeling exercise ➤ Since company owns its own warehouses, they will incur depreciation expenses
Interest Expense/Avg Debt	16.1%	8.0%	8.0%	➤ Current average is high since zero debt in 2002 led to lower denominator
Non-Operating Income/Sales	0.0%	0.0%	0.0%	No Non-Operating Income
Effective Tax Rate	20.9%	39.5%	39.5%	Will revert back to previous rate
Minority Interest/After Tax Income	0.0%	0.0%	0.0%	No Minority Interest
Other Income/Sales	0.0%	0.0%	0.0%	No Other Income
Ext. Items & Disc. Ops./Sales	-0.2%	0.0%	0.0%	
Pref. Dividends/Avg Pref. Stock	0.0%	0.0%	0.0%	Dividends not issued
Balance Sheet Assumptions:				
Working Capital Assumptions				
Ending Operating Cash/Sales	4.6%	4.6%	4.6%	No change
Ending Receivables/Sales	0.0%	0.0%	0.0%	No Receivables
Ending Inventories/COGS	34.2%	34.0%	30.0%	<ul style="list-style-type: none"> ➤ Decreasing inventory levels due to: <ul style="list-style-type: none"> - Implementation of new technology - Better inventory management

				- Focused product categories - Better merchandising
Ending Other Current Assets/Sales	3.5%	3.5%	3.5%	No Change
Ending Accounts Payable/COGS	6.7%	6.7%	6.7%	No Change
Ending Taxes Payable/Sales	0.0%	0.0%	0.0%	
Ending Other Current Liabs/Sales	7.2%	4.4%	4.4%	➤ Revert back to 5-year average as a realistic number
Other Operating Asset Assumptions				
Ending Net PP&E/Sales	14.5%	14.0%	10.0%	➤ Assuming that <i>growth</i> in distribution centers will reduce ➤ Distribution centers which are clustered around stores will service new stores leading to increased sales at existing PP&E levels
Ending Investments/Sales	0.0%	0.0%	0.0%	No Change
Ending Intangibles/Sales	0.0%	0.0%	0.0%	No Change
Ending Other Assets/Sales	0.3%	0.3%	0.3%	No Change
Other Operating Liability Assumptions				
Other Liabilities/Sales	0.0%	0.0%	0.0%	No Change
Deferred Taxes/Sales	0.0%	0.0%	0.0%	No Change
Financing Assumptions				
Current Debt/Total Assets	0.0%	0.0%	0.0%	No Change
Long-Term Debt/Total Assets	11.4%	11.4%	11.4%	No Change
Minority Interest/Total Assets	0.0%	0.0%	0.0%	No Change
Preferred Stock/Total Assets	0.0%	0.0%	0.0%	No Change
Dividend Payout Ratio	0.0%	0.0%	0.0%	No Change

(See **Appendices D and E** for recast Financial Statements and Forecasting Assumptions, respectively)

Forecasted valuation ratios for 2005 indicate a PEG of 1.37, P/E of 27.26, and a P/B of 2.15. Based on Exhibit 5, this will put BLI in the recovering dog category with the caveat that the industry averages used in the valuation ratio map will not change significantly.

EPS Forecast vs. Analyst Estimates

Analyst⁹ forecasts for FY2004 and FY2005 EPS are \$0.85 and \$1.05 respectively. This represents a two year EPS growth rate of 12.88% over FY2003 actual EPS of \$0.73. Our forecast offers EPS of \$0.82 and \$0.93 over the equivalent years, equivalent to 8.4% growth over two years (15% over 5 years, see **Appendix F** for EPS Forecasts). Analysts project a 12-month price target of \$20, assuming a P/E multiple of 23.0-24.0 (EPS of \$0.85) versus our \$22.84, P/E multiple of 27.3, and slightly lower EPS estimate. Our analysis anticipates lower Net Income estimates, slightly higher gross margins 43.5% in 2005 and 2006 versus 41.5%, and a lower SG&A estimate of 37.9% for both years versus 38.3% and 37.5% in successive years. We attribute their more optimistic 2006E to the lesser proportion of SG&A to sales (Analysts forecast sales growth of 9% for both years, versus our 13.5% and 12.7% for respective years giving us the higher P/E) and fewer shares outstanding in the ensuing period.

⁹ Equity Research McDonald Investment Inc. March 23, 2004 Company Update: Big Lots, Inc.

Valuation

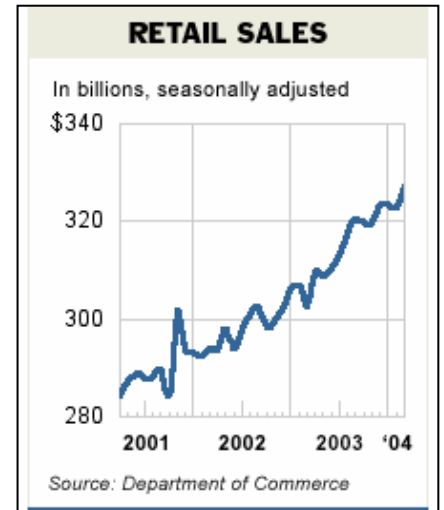
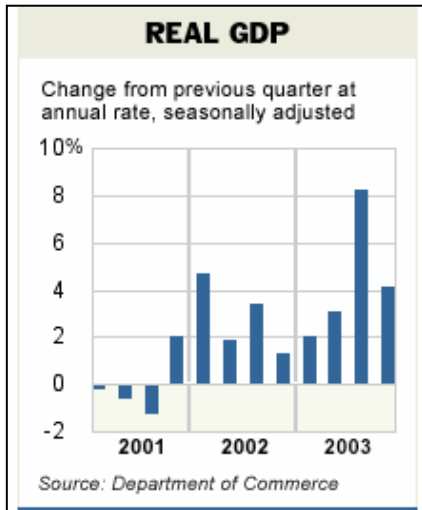
Valuation analysis refers to both Residual Income (RI) and Discounted Cash Flow (DCF) modeling. The present value of each years' residual income (10 years out), discounted at the 7.58% equity cost of capital, plus book value of common equity arrives at \$2.517 billion (See **Appendix G** for Residual Income Model). A positive RI tells us that the firm's ROE will exceed its cost of equity capital, and that the company is worth more than the book value of its common equity. An ROE greater than cost of equity is consistent with the company's strategy to grow and maximize profitability by only investing in what we perceive to be positive NPV projects. Using the RI model we estimate a \$22.84 share price.

The DCF model focuses on free cash flows to all investors rather than earnings flows (See **Appendix H** for Discounted Cash Flow Model and Sensitivity Analysis). The 7.65% cost of capital is the weighted average, per the capital structure of the firm, to the cost of equity capital determined using CAPM (risk free rate of 4%, beta as provided by Bloomberg of 0.716 and a market risk premium of 5%) and the cost of debt 8.21% (Senior Note interest rate). We believe that a 2.5% terminal growth rate from year 10 is conservative and reasonable, however we caution that the forecast and therefore the analysis is most sensitive to this perpetual growth rate. To illustrate, a 0.5% difference adds significantly to the enterprise value of the firm and resultant stock price. Using the DCF model we anticipate a per share price of \$22.73.

Recommendations & Concluding Remarks

We consider the key drivers of our valuation of BLI to be an increase in sales growth and operating efficiencies. Sales growth is expected primarily from increased customer transactions derived from the addition of new stores, store remodeling and increased advertising. Increased efficiencies will arise from scale economies as strategically located distribution centers that are breaking even now serve additional stores, efficiencies from consolidating three brands into one and having cut loose KB Toys. Although an increase in tax rates and pension liabilities decrease BLI's share price, this valuation gives us a \$22.84 per share price versus the market price of \$14.66 as of April 12, 2004. Based on our finding we therefore consider the BLI stock to be undervalued and we recommend a buy. It is important to recognize that the risk to this valuation consist of a change in macroeconomic factors that may not support our growth rate forecast of 13.55%.

Appendix A: Macroeconomic Trends



Appendix B: Pension Calculation

Appendix											
\$ '000											
Discount Rate:	6.80%	Projected Benefit Obligation at beginning of fiscal year 2004:		\$ 54,154.00							
Expected Rate of Return:	8.50%	Fair Value of Plan Assets:		\$ 42,601.00							
		Amount Underfunded:		\$ 11,553.00							
		1	2	3	4	5	6	7	8	9	10
	Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Annual Contribution	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42	\$ 256.42
Beginning Balance			\$ 278.22	\$ 580.08	\$ 907.61	\$ 1,262.97	\$ 1,648.54	\$ 2,066.88	\$ 2,520.78	\$ 3,013.27	\$ 3,547.61
Ending Balance		\$ 256.42	\$ 534.64	\$ 836.50	\$ 1,164.03	\$ 1,519.39	\$ 1,904.96	\$ 2,323.30	\$ 2,777.20	\$ 3,269.69	\$ 3,804.03
PV		\$ 240.09	\$ 468.72	\$ 686.68	\$ 894.70	\$ 1,093.49	\$ 1,283.68	\$ 1,465.91	\$ 1,640.73	\$ 1,808.69	\$ 1,970.30
Total	\$ 11,553.00										

Appendix C: SG&A Before and After Pension Expense

	Sales			SG & A		
	2003	2002	2001	2003	2002	2001
Big Lots (BLI)	4,174,383,000	3,868,550,000	3,433,321,000	1,616,031,000	1,485,265,000	1,368,397,000
Ninety Nine Cents (NDN)	862,460,000	713,942,000	578,269,000	234,626,000	178,374,000	141,544,000
Dollar General (DG)	6,871,992,000	6,100,404,000	5,322,895,000	1,496,866,000	1,296,542,000	1,135,801,000
Dollar Tree (DLTR)	2,799,872,000	2,329,188,000	1,987,271,000	N/A	594,035,000	458,329,000
Family Dollar Stores (FDO)	4,750,171,000	4,162,652,000	3,665,362,000	1,214,658,000	1,054,298,000	927,679,000

Appendix D: Financial Statements

Big Lots, Inc.											
Estimated Price/Share=\$22.84	22.84										
Common Shares Outstanding	116,146										
	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Fiscal Year End (MM/DD/YYYY)	1/31/2004	1/31/2005	1/31/2006	1/31/2007	1/31/2008	1/31/2009	1/31/2010	1/31/2011	1/31/2012	1/31/2013	1/31/2014
Income Statement											
Sales (Net)	4,174,383	4,737,925	5,325,427	5,927,201	6,531,775	7,126,167	7,696,260	8,227,302	8,704,485	8,922,098	7,912,178
Cost of Goods Sold	(2,428,024)	(2,676,927)	(3,008,866)	(3,348,868)	(3,690,453)	(4,026,284)	(4,348,387)	(4,648,426)	(4,918,034)	(5,040,985)	(4,470,381)
Gross Profit	1,746,359	2,060,997	2,316,561	2,578,332	2,841,322	3,099,882	3,347,873	3,578,876	3,786,451	3,881,112	3,441,797
R&D Expense	0	0	0	0	0	0	0	0	0	0	0
SG&A Expense	(1,616,031)	(1,800,411)	(2,018,337)	(2,240,482)	(2,462,479)	(2,679,439)	(2,886,097)	(3,077,011)	(3,246,773)	(3,319,020)	(2,864,208)
EBITDA	130,328	260,586	298,224	337,850	378,843	420,444	461,776	501,865	539,678	562,092	577,589
Depreciation & Amortization	0	(83,743)	(91,579)	(99,439)	(106,818)	(113,501)	(119,275)	(123,943)	(127,332)	(127,940)	(143,916)
EBIT	130,328	176,843	206,644	238,412	272,025	306,943	342,501	377,923	412,346	434,152	433,673
Interest Expense	(16,443)	(17,168)	(18,982)	(20,903)	(22,789)	(24,592)	(26,265)	(27,762)	(29,036)	(29,727)	(29,681)
Non-Operating Income (Loss)	1,061	1,204	1,354	1,507	1,660	1,811	1,956	2,091	2,212	2,268	2,011
EBT	114,946	160,878	189,017	219,015	250,896	284,162	318,192	352,252	385,522	406,692	406,003
Income Taxes	(24,051)	(63,547)	(74,662)	(86,511)	(99,104)	(112,244)	(125,686)	(139,140)	(152,281)	(160,643)	(160,371)
Minority Interest in Earnings	0	0	0	0	0	0	0	0	0	0	0
Other Income (Loss)	0	0	0	0	0	0	0	0	0	0	0
Net Income Before Ext. Items	90,895	97,331	114,355	132,504	151,792	171,918	192,506	213,112	233,241	246,049	245,632
Ext. Items & Disc. Ops.	(9,720)	0	0	0	0	0	0	0	0	0	0
Preferred Dividends	0	0	0	0	0	0	0	0	0	0	0
Net Income (available to common)	81,175	97,331	114,355	132,504	151,792	171,918	192,506	213,112	233,241	246,049	245,632
Balance Sheet											
Operating Cash and Market. Sec.	191,228	217,044	243,957	271,524	299,220	326,449	352,565	376,892	398,751	408,720	362,456
Receivables	0	0	0	0	0	0	0	0	0	0	0
Inventories	829,569	910,155	1,010,979	1,111,824	1,210,469	1,304,516	1,391,484	1,468,902	1,534,427	1,552,623	1,527,369
Other Current Assets	146,803	166,621	187,282	208,445	229,707	250,610	270,659	289,334	306,116	313,769	278,252
Total Current Assets	1,167,600	1,293,821	1,442,219	1,591,794	1,739,395	1,881,575	2,014,708	2,135,129	2,239,294	2,275,112	2,168,077
PP&E (Net)	605,527	663,309	724,258	782,390	836,067	883,645	923,551	954,367	974,902	963,587	1,107,705
Investments	0	0	0	0	0	0	0	0	0	0	0
Intangibles	0	0	0	0	0	0	0	0	0	0	0
Other Assets	11,561	13,122	14,749	16,415	18,090	19,736	21,315	22,786	24,107	24,710	21,913
Total Assets	1,784,688	1,970,252	2,181,226	2,390,600	2,593,552	2,784,956	2,959,574	3,112,281	3,238,303	3,263,409	3,297,695
Current Debt											
Accounts Payable	161,884	178,479	200,611	223,280	246,054	268,445	289,921	309,925	327,901	336,098	298,054
Income Taxes Payable	0	0	0	0	0	0	0	0	0	0	0
Other Current Liabilities	301,702	208,469	234,319	260,797	287,398	313,551	338,635	362,001	382,997	392,572	370,290
Total Current Liabilities	463,586	386,948	434,929	484,076	533,452	581,996	628,556	671,926	710,898	728,671	668,344
Long-Term Debt	204,000	225,211	249,327	273,259	296,458	318,336	338,296	355,751	370,157	373,026	376,945
Other Liabilities	1,042	1,183	1,329	1,480	1,630	1,779	1,921	2,054	2,173	2,227	1,975
Deferred Taxes	0	0	0	0	0	0	0	0	0	0	0
Minority Interest	0	0	0	0	0	0	0	0	0	0	0
Total Liabilities	668,628	613,342	685,585	758,815	831,540	902,111	968,773	1,029,732	1,083,228	1,103,924	1,047,265
Preferred Stock	0	0	0	0	0	0	0	0	0	0	0
Paid in Common Capital (Net)	459,205	602,724	627,099	630,739	609,174	558,088	473,539	352,176	191,461	(50,179)	(88,798)
Retained Earnings	656,855	754,186	868,541	1,001,045	1,152,838	1,324,756	1,517,262	1,730,374	1,963,615	2,209,664	2,339,229
Total Common Equity	1,116,060	1,356,910	1,495,641	1,631,785	1,762,012	1,882,844	1,990,800	2,082,550	2,155,076	2,159,485	2,250,431
Total Liabilities and Equity	1,784,688	1,970,252	2,181,226	2,390,600	2,593,552	2,784,956	2,959,574	3,112,281	3,238,303	3,263,409	3,297,695

Appendix E: Forecasting Assumptions

Big Lots, Inc.												TERMINAL
Estimated Price/Share=\$22.84												YEAR
	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Fiscal Year End Date	1/31/2004	1/31/2005	1/31/2006	1/31/2007	1/31/2008	1/31/2009	1/31/2010	1/31/2011	1/31/2012	1/31/2013	1/31/2014	1/31/2015
Implied Return on Equity	0.076	0.079	0.080	0.085	0.089	0.094	0.099	0.105	0.110	0.114	0.121	0.128
Income Statement Assumptions												
Sales Growth	7.9%	13.5%	12.4%	11.3%	10.2%	9.1%	8.0%	6.9%	5.8%	2.5%	2.5%	2.5%
Cost of Goods Sold/Sales	58.2%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%
R&D/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
SG&A/Sales	38.7%	38.0%	37.9%	37.8%	37.7%	37.6%	37.5%	37.4%	37.3%	37.2%	37.1%	37.0%
Dep&Amort/Avg PP&E and Intang.	0.0%	13.2%	13.2%	13.2%	13.2%	13.2%	13.2%	13.2%	13.2%	13.2%	13.2%	13.2%
Interest Expense/Avg Debt	16.1%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Non-Operating Income/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Effective Tax Rate	20.9%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%
Minority Interest/After Tax Income	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Income/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Ext. Items & Disc. Ops./Sales	-0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pref. Dividends/Avg Pref. Stock	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Balance Sheet Assumptions:												
Working Capital Assumptions												
Ending Operating Cash/Sales	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%
Ending Receivables/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Ending Inventories/COGS	34.2%	34.0%	33.6%	33.2%	32.8%	32.4%	32.0%	31.6%	31.2%	30.8%	30.4%	30.0%
Ending Other Current Assets/Sales	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Ending Accounts Payable/COGS	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%
Ending Taxes Payable/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Ending Other Current Liabs/Sales	7.2%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%
Other Operating Asset Assumptions												
Ending Net PP&E/Sales	14.5%	14.0%	13.6%	13.2%	12.8%	12.4%	12.0%	11.6%	11.2%	10.8%	10.4%	10.0%
Ending Investments/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Ending Intangibles/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Ending Other Assets/Sales	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Other Operating Liability Assumptions												
Other Liabilities/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Deferred Taxes/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Financing Assumptions												
Current Debt/Total Assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Long-Term Debt/Total Assets	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%
Minority Interest/Total Assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Preferred Stock/Total Assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Appendix F: EPS Forecast vs. Analyst (McDonald Investment, Inc.) Estimates

Fiscal Year of Forecast	Forecast 1/31/2005	Forecast 1/31/2006	Forecast 1/31/2007	Forecast 1/31/2008	Forecast 1/31/2009	Forecast 1/31/2010
Net Income	97,331	114,355	132,504	151,792	171,918	192,506
Common Equity Issued (Repurchased)	143,519	24,375	3,640	(21,565)	(51,086)	(84,550)
Forecasted Price at Year End	\$24.23	\$26.06	\$28.04	\$30.16	\$32.45	\$34.91
New Shares Issued (Repurchased)	5,924	935	130	(715)	(1,574)	(2,422)
Shares Outstanding at End of Year	122,070	123,005	123,135	122,420	120,846	118,424
Forecast EPS	\$0.82	\$0.93	\$1.08	\$1.24	\$1.41	\$1.61
Consensus Analyst Forecast of EPS	\$0.85	\$1.05				
Forecast Five Year Growth Rate in EPS			15%			
Consensus Analyst Forecast of Growth Rate			13%			

Appendix G: Residual Income Model

Most Recent Fiscal Year End	1/31/2004
Date of Valuation	4/12/2004
Cost of Common Equity	7.58%

Fiscal Year of Forecast	1/31/2005	1/31/2006	1/31/2007	1/31/2008	1/31/2009	1/31/2010	1/31/2011	1/31/2012	1/31/2013	1/31/2014	1/31/2015
Valuation to Common Equity											
Net Income	97,331	114,355	132,504	151,792	171,918	192,506	213,112	233,241	246,049	260,931	276,404
Common Equity at Beginning of Year	1,116,060	1,356,910	1,495,641	1,631,785	1,762,012	1,882,844	1,990,800	2,082,550	2,155,076	2,159,485	2,162,767
Residual Income	12,734	11,501	19,134	28,103	38,358	49,786	62,210	75,384	82,694	97,242	112,467
Present Value of Residual Income	11,837	9,938	15,368	20,981	26,619	32,116	37,303	42,017	42,844	46,832	50,347
Present Value Beyond 20 Years	689,231										
Present Value of First 20 Years	712,177										
Common Equity as of:											
1/31/2004	1,116,060										
Forecast Equity Value Before Time Adj.	2,517,469										
Forecasted Value as of Valuation Date	2,652,492										
Less Value of Contingent Equity Claims	0										
Value Attributable to Common Equity	2,652,492										
Common Shares Outstanding at BS Date	116,146										
Equivalent Shares at Valuation Date	116,146										
Forecast Price/Share	\$22.84										

Appendix H: Discounted Cash Flow Model and Sensitivity Analysis

Big Lots DCF Sensitivity Analysis										
	0	1	2	3	4	5	6	7	8	9
Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
FCF	\$ (154,342.81)	\$ (37,007.04)	\$ (14,926.52)	\$ 12,153.80	\$ 44,085.30	\$ 80,480.52	\$ 120,703.69	\$ 163,876.65	\$ 256,755.38	
g =	2.5%									
Re =	7.7%								FCF (T +1) :	\$ 263,174.26
	Discount Rate	Perpetual Growth Rate	Total PV of Future Cash Flows	PV of Free Cash Flows 2005 to 2013	NPV Terminal Value	Terminal Value 2013	Net Debt	NPV Plus Debt	Shares Outstanding	Price per share
	7.0%	2.0%	\$ 3,078,769	\$ 215,782	\$ 2,862,987	\$ 5,263,485	\$ (191,228)	\$ 2,887,541	116146	24.86
	7.0%	2.5%	\$ 3,396,879	\$ 215,782	\$ 3,181,097	\$ 5,848,317	\$ (191,228)	\$ 3,205,651	116146	27.60
	7.0%	3.0%	\$ 3,794,516	\$ 215,782	\$ 3,578,734	\$ 6,579,357	\$ (191,228)	\$ 3,603,288	116146	31.02
	7.0%	3.5%	\$ 4,305,764	\$ 215,782	\$ 4,089,982	\$ 7,519,265	\$ (191,228)	\$ 4,114,536	116146	35.43
	7.0%	4.0%	\$ 4,987,428	\$ 215,782	\$ 4,771,645	\$ 8,772,475	\$ (191,228)	\$ 4,796,200	116146	41.29
	7.68%	2.0%	\$ 2,578,966	\$ 198,404	\$ 2,380,563	\$ 4,633,350	\$ (191,228)	\$ 2,387,738	116146	20.56
	7.68%	2.5%	\$ 2,808,750	\$ 198,404	\$ 2,610,347	\$ 5,080,584	\$ (191,228)	\$ 2,617,522	116146	22.54
	7.68%	3.0%	\$ 3,087,634	\$ 198,404	\$ 2,889,230	\$ 5,623,382	\$ (191,228)	\$ 2,896,406	116146	24.94
	7.68%	3.5%	\$ 3,433,235	\$ 198,404	\$ 3,234,832	\$ 6,296,035	\$ (191,228)	\$ 3,242,007	116146	27.91
	7.68%	4.0%	\$ 3,872,751	\$ 198,404	\$ 3,674,347	\$ 7,151,475	\$ (191,228)	\$ 3,681,523	116146	31.70
	8.0%	2.0%	\$ 2,384,786	\$ 190,575	\$ 2,194,211	\$ 4,386,238	\$ (191,228)	\$ 2,193,558	116146	18.89
	8.0%	2.5%	\$ 2,584,260	\$ 190,575	\$ 2,393,685	\$ 4,784,987	\$ (191,228)	\$ 2,393,032	116146	20.60
	8.0%	3.0%	\$ 2,823,628	\$ 190,575	\$ 2,633,053	\$ 5,263,485	\$ (191,228)	\$ 2,632,400	116146	22.66
	8.0%	3.5%	\$ 3,116,190	\$ 190,575	\$ 2,925,615	\$ 5,848,317	\$ (191,228)	\$ 2,924,962	116146	25.18
	8.0%	4.0%	\$ 3,481,892	\$ 190,575	\$ 3,291,316	\$ 6,579,357	\$ (191,228)	\$ 3,290,664	116146	28.33
	8.5%	2.0%	\$ 2,121,725	\$ 178,771	\$ 1,942,954	\$ 4,048,835	\$ (191,228)	\$ 1,930,497	116146	16.62
	8.5%	2.5%	\$ 2,283,638	\$ 178,771	\$ 2,104,866	\$ 4,386,238	\$ (191,228)	\$ 2,092,410	116146	18.02
	8.5%	3.0%	\$ 2,474,989	\$ 178,771	\$ 2,296,218	\$ 4,784,987	\$ (191,228)	\$ 2,283,761	116146	19.66
	8.5%	3.5%	\$ 2,704,611	\$ 178,771	\$ 2,525,840	\$ 5,263,485	\$ (191,228)	\$ 2,513,383	116146	21.64
	8.5%	4.0%	\$ 2,985,260	\$ 178,771	\$ 2,806,488	\$ 5,848,317	\$ (191,228)	\$ 2,794,032	116146	24.06
	9.0%	2.0%	\$ 1,898,507	\$ 167,468	\$ 1,731,039	\$ 3,759,632	\$ (191,228)	\$ 1,707,279	116146	14.70
	9.0%	2.5%	\$ 2,031,664	\$ 167,468	\$ 1,864,196	\$ 4,048,835	\$ (191,228)	\$ 1,840,436	116146	15.85
	9.0%	3.0%	\$ 2,187,014	\$ 167,468	\$ 2,019,546	\$ 4,386,238	\$ (191,228)	\$ 1,995,786	116146	17.18
	9.0%	3.5%	\$ 2,370,609	\$ 167,468	\$ 2,203,141	\$ 4,784,987	\$ (191,228)	\$ 2,179,381	116146	18.76
	9.0%	4.0%	\$ 2,590,923	\$ 167,468	\$ 2,423,455	\$ 5,263,485	\$ (191,228)	\$ 2,399,695	\$ 116,146	20.66
Cost of Equity Capital: $Re = Rf + \beta (Rm - Rf) =$			7.58%			Cost of Debt Capital:			8.21%	
Rf:	4%					<i>Source: BLI IOK: Note on Senior Note</i>				
β *	0.716									
Rm-Rf:	5%									
Total Shareholders Equity: \$1116 m			Long Term Debt: 204 m			WACC:		7.68%		
<i>* Source: Bloomberg Data</i>										