RadioShack (RSH)

Q2 Preview: Expect Dismal Results to Continue; Reiterate UNDERPERFORM, Lowering PT to $0

- **RadioShack will report Q2 results BMO on Thursday, September 11, and host a call at 7am PT (webcast: ir.radioshackcorporation.com).**
- **Expect results below consensus estimates as traffic continues to decline.** We expect revenue of $762 million vs. consensus of $893 million and EPS of ($0.66) compared to consensus of $(0.36). The company does not provide guidance.
- **We believe brick and mortar electronics retailers will see persistent structural decline as Internet sales continue to take share.** Best Buy experienced comp declines of 2.7% for Q2:15. Domestic Q2 sales were down 2% overall, and store level sales were down roughly 4% without the contribution of over $100 million incremental online sales. Notwithstanding significant investments in price competitiveness, we see continuing evidence of traffic deterioration and lower productivity for Best Buy's retail foot print. RadioShack has less financial flexibility to invest in price competitiveness, and its primary business is as a consumer electronics "convenience store". We believe the Internet is more convenient.
- **RadioShack is focusing on reducing costs, which includes closing up to 200 stores per year over the next three years.** RadioShack's negotiations with creditors are currently preventing the company from pursuing its initial plan of closing up to 1,100 stores over the next year, but the company is focusing on other cost-reduction initiatives such as: lowering rent expense through negotiations with landlords, reducing compensation expense by optimizing labor hours and store operating hours, and reviewing other expenses for cost-reduction opportunities.
- **In May, RadioShack announced that it was unable to successfully negotiate consent from its lenders under the 2018 Credit Agreement and Term Loan to close up to 1,100 stores.** The terms offered by lenders were not acceptable to the company. RadioShack's operational decisions are now being vetted by creditors and equity investors are no longer relevant to management decisions—the creditors clearly are in control of the ship and, in our view, the ship is sinking. The credit agreement allows the closure of 200 stores per year or 600 over the life of the agreement. We believe a bankruptcy reorganization is imminent.
- **Reiterating our UNDERPERFORM rating and lowering our 12-month price target to $0 from $1 as declining CE sales and continued margin erosion will likely compel the company to enter bankruptcy in order to pursue its turnaround.** Our price target reflects our expectation that creditors will force a reorganization and wipe out RadioShack's equity.

FYE Dec	2012A	2013A			2014E		
REV (M)	**ACTUAL**	**CURR.**	**PREV.**	**CONS.**	**CURR.**	**PREV.**	**CONS.**
Q1 Mar	$913A	$849A		--	$737A		$767A
Q2 Jun	849A	$844A		--	$762E		893E
Q3 Sep	898A	$805A		--	$711E		1,121E
Q4 Dec	1,171A	$935A		--	$792E		N/AE
Year*	**$3,831A**	**$3,434A**		**--**	**$3,002E**		**N/AE**
Change	-12.5%	-10.4%			-12.6%		
	2012A	**2013A**			**2014E**		
EPS	**ACTUAL**	**CURR.**	**PREV.**	**CONS.**	**CURR.**	**PREV.**	**CONS.**
Q1 Mar	($0.05)A	($0.35)A		--	($0.98)A		($0.52)A
Q2 Jun	(0.16)A	($0.53)A		--	($0.66)E		(0.36)E
Q3 Sep	(0.17)A	($0.71)A		--	($0.71)E		(0.14)E
Q4 Dec	0.08A	($1.29)A		--	($0.74)E		N/AE
Year*	**($0.30)A**	**($2.88)A**		**--**	**($3.09)E**		**N/AE**
P/E	(4.0)x	(0.4)x			(0.4)x		
Change	-131.8%	853.1%			7.3%		

Consensus estimates are from Thomson First Call.
** Numbers may not add up due to rounding.*

September 9, 2014

Price
$1.22

Rating
UNDERPERFORM

12-Month Price Target
$0 **(from $1)**

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Company Information

Shares Outst (M)	101
Market Cap (M)	$124
52-Wk Range	$0.55 - $4.36
Book Value/sh	$0.72
Cash/sh	$0.61
Enterprise Value (M)	$676
LT Debt/Cap	496%

Company Description

RadioShack, based in Fort Worth, Texas, sells consumer electronic goods and services, through its RadioShack store chain and non-RadioShack branded kiosk operations.

Source: Thomson Reuters

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RISKS

Risks to attainment of our share price target include changes to the macroeconomic outlook, variability in new product release timing, the effects of competition from other consumer electronic and big-box retailers and changes in consumer demand for consumer electronics.

INVESTMENT THESIS

We believe that RadioShack's core consumer electronics products drive foot traffic in its stores, leading to incremental mobility and other high-margin product sales. In our view, people go to RadioShack with the intention of purchasing a core product, and some end up buying a cell phone case or, now and then, a cell phone; we do not believe that RadioShack is a destination for cell phone purchases. RadioShack is a destination for CE, which has become an increasingly commoditized business, and one in which RadioShack has seen consistently declining sales. In our view, declining traffic is the primary issue; if fewer consumers visit RadioShack for its core products, sales of its mobility and other high-margin products will continue to suffer. Company management has said in the past that RadioShack is a destination for smartphone accessories and other accessories; as difficult as this is to believe, even if it were true, we would not view this as an incremental positive due to the vastly lower gross profit dollar contribution compared to its declining CE and smartphones business. It appears that management is now facing a dwindling cash balance, compromised liquidity, and continuing market share losses. With that said, CEO Joseph Magnacca appears focused on returning to growth with what appear to be sound, traffic-driving ideas. However, we are skeptical that his efforts will bear fruit over the near term given the late stage of decline and what we consider to be lasting damage to the RadioShack brand. Notwithstanding the attempt, we expect RadioShack's core consumer electronics business to continue its slide, manifesting itself as slower foot traffic to RadioShack stores. While management appears committed to spending on new initiatives to recapture its lost customers, its liquidity continues to shrink. It appears to us that RadioShack is destined to continue to lose money, and we believe that the company's spending on new initiatives and international growth will exacerbate its problems in the near term. We do not see a light at the end of this tunnel at least until the company demonstrates that it can generate consistent profits and begin to grow its cash balance. We therefore rate shares UNDERPERFORM.

INCOME STATEMENT

RadioShack

Income Statement ($ millions) Fiscal Year End: Dec 31	Mar-13 Q1A	Jun-13 Q2A	Sep-13 Q3A	Dec-13 Q4A	2013 FY-A	Jan-14 Stub	Apr-14 Q1A	Jul-14 Q2E	Oct-14 Q3E	Jan-15 Q4E	2015 FY-E
Total revenue	**849.0**	**844.5**	**805.4**	**935.4**	**3,434.3**	**227.0**	**736.7**	**761.8**	**711.3**	**792.1**	**3,002.0**
Cost of sales	511.7	530.7	562.7	657.0	2,262.1	139.2	468.0	480.0	458.8	522.8	1,929.6
Gross profit	337.3	313.8	242.7	278.4	1,172.2	87.8	268.7	281.9	252.5	269.3	1,072.4
Selling, general & admin expenses	337.9	336.9	343.3	389.3	1,407.4	115.9	335.9	335.2	313.0	332.7	1,316.8
Depreciation & amortization	16.5	15.5	15.0	14.4	61.4	4.3	13.0	16.0	15.0	14.0	58.0
Impairment and other charges	1.4	2.8	2.4	40.8	47.4	0.5	0.8	1.1	1.5	4.0	7.4
Operating Income	**(18.5)**	**(41.4)**	**(118.0)**	**(166.1)**	**(344.0)**	**(32.9)**	**(81.0)**	**(70.4)**	**(77.0)**	**(81.4)**	**(309.8)**
Interest income	0.4	0.3	0.3	1.2	2.2	0.1	0.7	0.0	0.0	0.1	0.9
Interest expense	(15.0)	(14.1)	(11.5)	(11.7)	(52.3)	(6.0)	(16.6)	(12.7)	(12.7)	(12.7)	(54.8)
Other income (loss)	(0.3)	-	-	(10.6)	(10.9)	-	-	-	-	-	-
Total non-operating (income)/expense	(14.9)	(13.8)	(11.2)	(21.1)	(61.0)	(5.9)	(15.9)	(12.7)	(12.7)	(12.6)	(53.9)
Pretax Income	**(33.4)**	**(55.2)**	**(129.2)**	**(187.2)**	**(405.0)**	**(38.8)**	**(96.9)**	**(83.1)**	**(89.7)**	**(94.0)**	**(363.7)**
Provision for income taxes	1.4	(1.8)	(16.8)	4.2	(13.0)	(1.1)	1.4	(16.6)	(17.9)	(18.8)	(52.0)
Discontinued operations	(8.5)	0.3	-	-	(8.2)	-	-	-	-	-	-
Net Income	(43.3)	(53.1)	(112.4)	(191.4)	(400.2)	(37.7)	(98.3)	(66.5)	(71.7)	(75.2)	(311.7)
Loss from Continuing Operations	(34.8)	(53.4)	(112.4)	(191.4)							
Preferred dividends	-	-	-	-	-	-	-	-	-	-	-
Net income available to common	**(43.3)**	**(53.1)**	**(112.4)**	**(191.4)**	**(400.2)**	**(37.7)**	**(98.3)**	**(66.5)**	**(71.7)**	**(75.2)**	**(311.7)**
Basic shares	100.4	100.7	101.0	101.0	100.8	101.1	101.3	101.3	101.3	101.3	101.3
Diluted shares	100.4	100.7	101.0	101.0	100.8	101.1	101.3	101.3	101.3	101.3	101.3
Basic EPS	(0.43)	(0.53)	(1.11)	(1.90)	(3.97)	(0.37)	(0.97)	(0.66)	(0.71)	(0.74)	(3.08)
Diluted EPS	(0.43)	(0.53)	(1.11)	(1.90)	(3.97)	(0.37)	(0.97)	(0.66)	(0.71)	(0.74)	(3.08)
Continuing Ops Diluted EPS	(0.35)	(0.53)	(1.11)	(1.90)	(3.89)	(0.37)	(0.97)	(0.66)	(0.71)	(0.74)	(3.08)
Discontinued Ops	(0.08)	0.00	0.00	0.00	**(0.08)**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pro forma EPS adjustment	0.00	0.00	0.40	0.61	1.01	0.00	(0.01)	0.00	0.00	0.00	(0.01)
Continuing Diluted EPS (Pro Forma)	**($0.35)**	**($0.53)**	**($0.71)**	**($1.29)**	**($2.88)**	**($0.37)**	**($0.98)**	**($0.66)**	**($0.71)**	**($0.74)**	**($3.09)**

Income Statement Ratios	Mar-13	Jun-13	Sep-13	Dec-13	2013	Jan-14	Apr-14	Jul-14	Oct-14	Jan-15	2015
Gross Margin	39.7%	37.2%	30.1%	29.8%	34.1%	38.7%	36.5%	37.0%	35.5%	34.0%	35.7%
SG&A	39.8%	39.9%	42.6%	41.6%	41.0%	51.1%	45.6%	44.0%	44.0%	42.0%	43.9%
Depreciation & amortization	1.9%	1.8%	1.9%	1.5%	1.8%	1.9%	1.8%	2.1%	2.1%	1.8%	1.9%
Operating margin	(2.2%)	(4.9%)	(14.7%)	(17.8%)	(10.0%)	(14.5%)	(11.0%)	(9.2%)	(10.8%)	(10.3%)	(10.3%)
Net margin	(5.1%)	(6.3%)	(14.0%)	(20.5%)	(11.7%)	(16.6%)	(13.3%)	(8.7%)	(10.1%)	(9.5%)	(10.4%)
Tax rate	(4.2%)	3.3%	13.0%	(2.2%)	3.2%	2.8%	(1.4%)	20.0%	20.0%	20.0%	14.3%

Year-over-Year Changes	Mar-13	Jun-13	Sep-13	Dec-13	2013	Jan-14	Apr-14	Jul-14	Oct-14	Jan-15	2015
Comps	**(5.7%)**	**1.3%**	**(8.4%)**	**(19.0%)**	**(8.0%)**	**(17.8%)**	**(13.8%)**	**(7.0%)**	**(7.0%)**	**(7.0%)**	**(8.7%)**
Company store growth	(2.3%)	(2.5%)	(2.7%)	(2.2%)	(2.2%)	(1.4%)	(1.9%)	(2.1%)	(3.5%)	(5.1%)	(5.1%)
Other site growth	(5.4%)	(4.3%)	(2.6%)	(4.8%)	(4.8%)	(4.6%)	(7.7%)	(8.4%)	(9.5%)	(9.2%)	(9.2%)
Net sales	**(7.0%)**	**(0.5%)**	**(10.3%)**	**(20.1%)**	**(10.4%)**	**(94.1%)**	**(13.2%)**	**(9.8%)**	**(11.7%)**	**(15.3%)**	**(12.6%)**
Cost of goods sold	(5.8%)	4.4%	1.0%	(12.6%)	(4.2%)	(94.1%)	(8.5%)	(9.6%)	(18.5%)	(20.4%)	(14.7%)
Gross profit	(8.9%)	(7.8%)	(28.8%)	(33.6%)	(20.3%)	(94.0%)	(20.3%)	(10.2%)	4.0%	(3.3%)	(8.5%)
SG&A	(2.1%)	(0.0%)	(3.0%)	1.5%	(0.9%)	(91.8%)	(0.6%)	(0.5%)	(8.8%)	(14.5%)	(6.4%)
Depreciation & amortization	(4.1%)	(4.9%)	248.8%	(12.2%)	13.3%	(92.1%)	(21.2%)	3.2%	0.0%	(2.8%)	(5.5%)
Operating income	NM	NM	NM	########	NM	NM	NM	NM	NM	NM	(10.0%)
Net income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	(22.1%)
Diluted EPS	NM	NM	NM	########	NM	NM	NM	NM	NM	NM	7.3%

Sources: Company reports and Wedbush Securities estimates.

Analyst Biography

Michael Pachter is the Managing Director of Equity Research, covering the Digital Media sector, and is also the Head of Research for the Private Shares Group. He has been recognized as StarMine's Top Earnings Estimator for a number of years and Best on the Street by the Wall Street Journal. Michael brings over 20 years of experience as a financial professional to both the Equity Research Department and the Private Shares Group along with extensive knowledge across the social media sector in both public and private companies.
Mr. Pachter holds an M.B.A. from the Anderson School at the University of California at Los Angeles, a Juris Doctor from Pepperdine University, an LL.M. in Taxation from the University of Florida, and a bachelor's degree in Political Science from California State University, Northridge.
Michaels' Edge: Michael has over 30 years of work experience, holding various financial and management positions in industry and having been at Wedbush for 13 years. Michael is one of the most quoted and outspoken analysts in the Video Games Sector and is often among the first called by journalists covering the sector. Michael's breadth of industry knowledge and contacts in the entertainment industry provides him with exceptional insights into industry trends and ideas. Michael believes he is the "Why" and What's Next source that investors turn to for insights into why events are happening in the sector and how they will progress.

Covered Public Companies Mentioned in this Report (priced as of close 9/8/14)

COMPANY	TICKER	RATING	PRICE	PRICE TARGET
BEST BUY	BBY	UNDERPERFORM	$32.14	$18

Analyst Certification
I, Michael Pachter, Nick Citrin, Nick McKay, certify that the views expressed in this report accurately reflect my personal opinion and that I have not and will not, directly or indirectly, receive compensation or other payments in connection with my specific recommendations or views contained in this report.

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Neutral: Expect the total return of the stock to perform in-line with the median total return of the analyst's (or the analyst's team) coverage universe over the next 6-12 months.
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Outperform:54% Neutral: 42% Underperform: 4%	Outperform:25% Neutral: 1% Underperform: 0%

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Wedbush Equity Research Disclosures as of September 9, 2014

Company	Disclosure
RadioShack	1
Best Buy	1

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2. WS managed a public offering of securities within the last 12 months.
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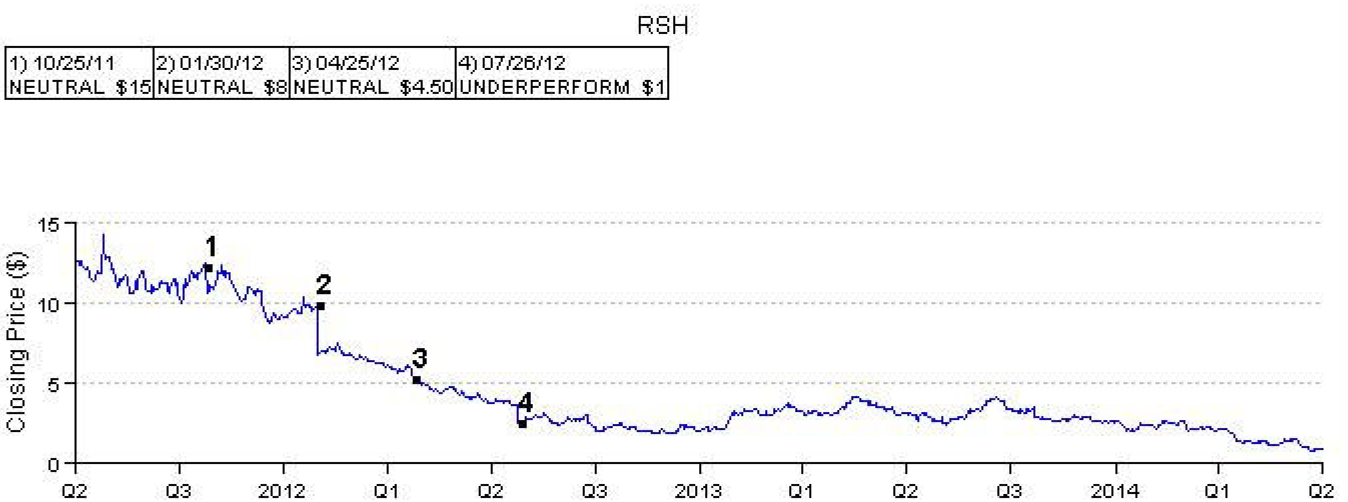

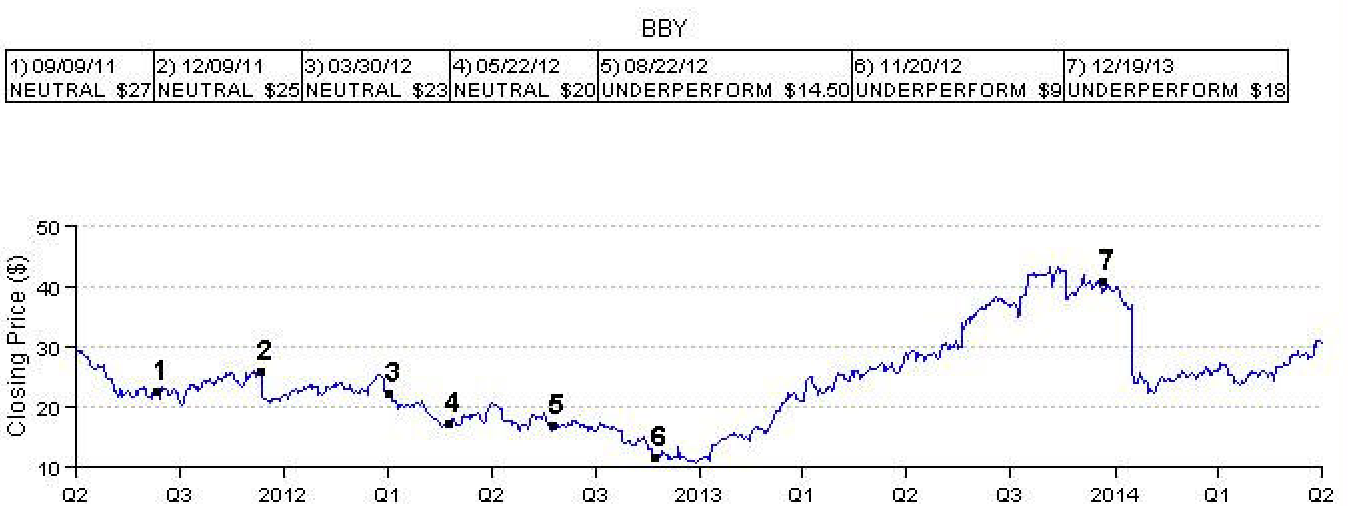

* WS changed its rating system from (Strong Buy/Buy/Hold/Sell) to (Outperform/ Neutral/Underperform) on July 14, 2009.
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