



## Whole Foods Market

(NASDAQ: WFMI)

Company Update  
EPS Upgrade

### Outperform

Average Risk

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Price: 45.81      Price Target: 60.00  
 52-Wk High: 54.59      52-Wk Low: 35.47  
 Float (MM): 56.8      Debt to Cap: 21.2%  
 Shares Out (MM): 61.5      Market Cap (MM): 2,817  
 Dividend: 0.00      Yield: 0.0%  
 Tr. 12 ROE: 16.80%      Est 3-Yr EPS Gr: 20.00%  
 Trading Vol. (MM): 0.700  
 Institutional Own.: 85%

(FY Sep)	2001A	2002A	2003E	2004E
Diluted EPS	1.12	1.40	1.71	2.03
Prev.			1.68	
P/E	40.90x	32.72x	26.79x	22.57x
Diluted EPS	Q1	Q2	Q3	Q4
2001	0.27A	0.27A	0.29A	0.29A
2002	0.34A	0.34A	0.36A	0.36A
2003	0.42A	0.43E	0.45E	0.42E
Prev.	0.38E			
2004	0.48E	0.52E	0.53E	0.50E

All values in USD unless otherwise noted.

## Reports Better-Than-Expected Q1 Sales And Earnings

### Event

Whole Foods reported better-than-expected Q1 sales and earnings.

### Investment Conclusion

- EPS of \$0.42 (vs. \$0.34 last yr.) beat our estimate by \$0.04 and consensus by \$0.02.
- With comps of 10.5%, Whole Foods continues to defy the current retail environment.
- Gaining expense leverage at both the store and corporate level.
- Opening bigger and better stores should sustain strong comps.
- Well deserving of a premium valuation, in our view, reiterate Outperform rating and \$60 price target.

### Valuation

Our \$60 price target reflects a multiple of 28x our calendar 2004 EPS estimate of \$2.13. At a multiple of 28x, Whole Foods' P/E would be at a 10% premium compared to current forward P/E multiples for other "category killer" retailers. We believe this premium is reasonable, given: 1) Whole Foods' comps are superior to those of its peers; 2) our earnings estimates are likely conservative; and 3) we believe Whole Foods has greater potential for square footage growth. We also believe our earnings estimates will prove conservative.

### Impediment

We believe Whole Foods' strong relative performance has been driven, in large part, by robust comps over the past two years. As a result, an unexpected slowdown in comps could erode WFMI's premium valuation and impede achievement of our price target.

### We Love The Sound Of This Broken Record

Whole Foods reported another quarter of upside to our estimates for comps and earnings. EPS of \$0.42 (vs. \$0.34 last year) exceeded our estimate by \$0.04 and beat consensus by \$0.02. Earnings would have even been a penny higher if not for writedown of Whole Foods' investment in Gaiam. Comps of 10.5% were unchanged from last quarter despite a 56 basis point impact from three acquired Harry's stores, which entered the comp base during the quarter.

For pertinent disclosure, see Disclosure section at the end of this report.

1Q03 marks the sixth quarter of double digit comps in the past seven quarters. Below, we review some of the many positives included in Whole Foods Q1 release:

- Stores of all ages continue to report strong comps. Comps for newer stores continue to accelerate, supporting our belief that Whole Foods continues to improve its retail concept.
- The company gained expense leverage at both the store level and corporate level. We are particularly impressed with the 78 basis point improvement in contribution margins of stores in the comp base (9.5% vs. 8.7% last year).
- This expense leverage was achieved despite higher health care expenses, as the company increased its employee healthcare benefits. While the benefit of this spending is intangible, the effect of having happy employees is clearly evident in Whole Foods' performance.
- Stores opened during the quarter appear to be winners. Pittsburgh and New Orleans are already among the company's top 25 stores for average weekly sales. Successful new store openings such as these are the key ingredient to sustaining strong comps.
- Performance remains strong even in tough markets such as northern California, where the economy has taken its toll on consumer spending.

### **Strong Pipeline For New Stores**

In addition to the strong results, we are pleased with new developments on the expansion front. Never before has pipeline for new stores been this strong. The company signed leases for seven additional stores and now has 23 stores in development totaling more than 1 million square feet. Whole Foods continues to increase its average store size. Stores in development average 42,000 square feet, vs. the company's average of just over 30,000 square feet. All evidence suggests that larger stores produce higher sales per square foot, stronger comps, and better profitability metrics. Over the past 5 years, as the company has opened larger stores, its average store size has grown 22%, its average weekly sales have increased 40% and its average annual contribution dollars per store has improved approximately 77%.

Interestingly, the company reiterated its goal of \$10 billion in sales by 2010, but revised its goal for total stores by 2010 to 300 from 400. We view this as a positive reflection of Whole Foods' strong business momentum. Whole Foods' new long term goal implies a 33% increase in expected volume per store. Because increasing average store size cannot account for the entire productivity increase, management's new goal assumes increased expectations for sales per square foot and implies a more optimistic view of long-term comps. We find this somewhat ironic, since management's previously aggressive goal for new store openings has been a source of investor concern.

### **Guidance Appears Conservative**

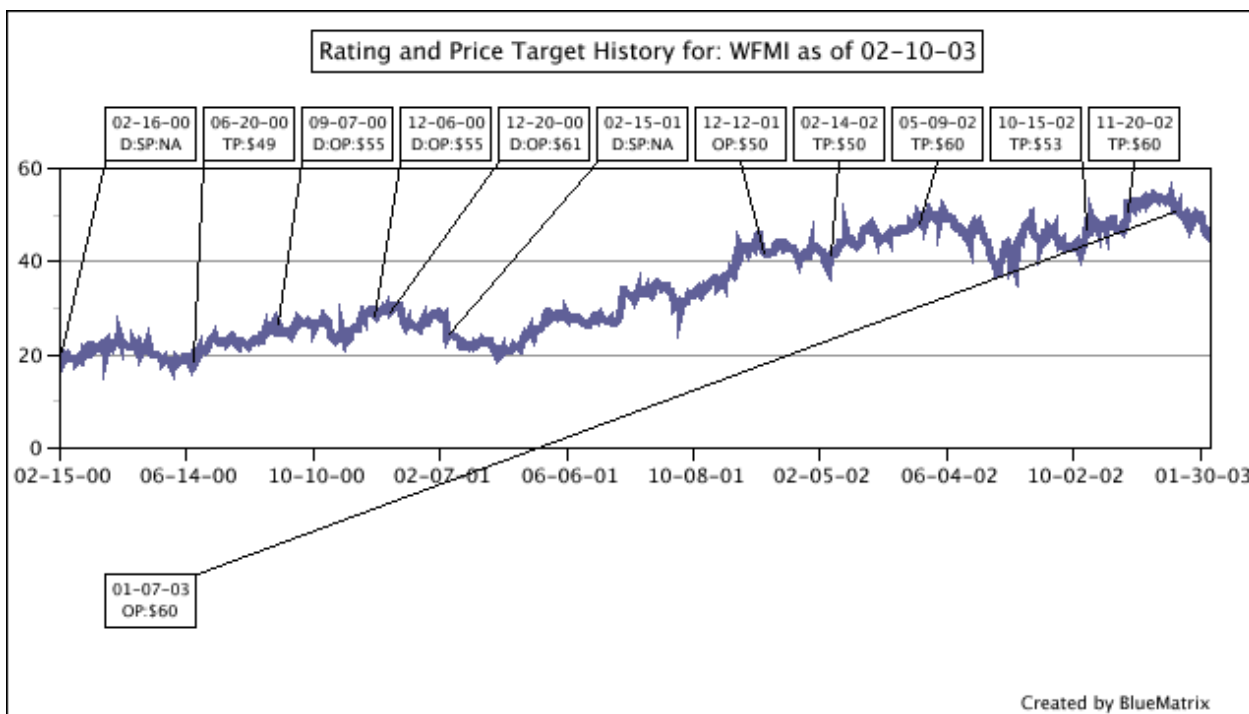
Consistent with its practice of under-promising and over-delivering, management maintained its 2003 earnings guidance to \$1.62-\$1.69. The company stated expectations for comps of 8.0%-9.0% in 2Q02 and 6.5%-8.5% for the remainder of the year. We believe management's sales and earnings guidance is conservative and we believe earnings guidance will likely be revised upward in next quarter's earnings release. We are raising our Q2 comp expectation to 9.0% from 8.5%, and we are raising our full-year estimate to \$1.71 from \$1.68. Note that our quarterly earnings estimates for the remainder of the year remain unchanged.

### **Company Description**

Whole Foods Market, Inc. owns and operates the country's largest chain of natural foods supermarkets.

### **Disclosures**

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Rating	RBC Capital Markets		IB Serv./Past 12 Mos.	
	Count	Percent	Count	Percent
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**Whole Foods Market, Inc.**  
**Earnings Model**  
(In thousands, except per share amounts)

	1996	1997	1998	1999	2000	2001	1/16/02	4/14/02	7/2/02	9/26/02	2002	1/16/03A	4/9/03E	7/2/03E	9/26/03E	2003E	1/16/04E	4/9/04E	7/2/04E	9/26/04E	2004E
<b>Total sales</b>	892,098	1,049,283	1,308,070	1,492,111	1,837,922	2,272,231	780,799	622,789	648,763	638,124	2,690,475	923,760	736,994	754,664	736,943	3,152,361	1,054,427	838,307	862,370	852,106	3,607,209
Cost of goods sold	613,056	709,693	875,851	988,716	1,204,344	1,482,477	516,077	404,690	422,618	413,828	1,757,213	609,190	479,046	491,286	477,539	2,057,061	696,976	544,061	560,540	551,313	2,352,890
<b>Gross profit</b>	279,042	339,590	432,219	503,395	633,578	789,754	264,722	218,099	226,145	224,296	933,262	314,570	257,948	263,378	259,404	1,095,300	357,451	294,246	301,829	300,793	1,254,319
Direct store expenses (1)		257,576	314,383	362,537	460,060	574,021	197,297	154,148	161,409	162,906	675,760	233,544	182,774	187,534	187,184	791,036	264,661	205,385	212,143	215,583	897,772
<b>Store contribution</b>		82,014	117,836	140,858	173,518	215,733	67,425	63,951	64,736	61,390	257,502	81,026	75,173	75,844	72,220	304,264	92,790	88,861	89,686	85,211	356,547
General and admin.	250,607	33,308	40,796	50,114	54,821	78,953	28,180	22,981	22,919	21,791	95,871	31,176	27,269	26,413	25,056	109,914	37,959	30,179	30,183	28,972	127,293
Pre-opening & relocation	5,903	5,243	3,979	5,914	10,459	8,539	2,239	5,382	3,273	1,591	12,485	3,836	2,175	1,450	2,175	9,636	3,000	3,000	3,000	3,000	12,000
Amortization expense		2,415	2,841	3,507	5,926	7,098	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-recurring expenses (2,3,4,10)	40,455	4,887	1,699	5,940		9,425															
<b>Income from operations</b>	22,532	41,048	70,220	81,323	102,312	121,143	37,006	35,588	38,544	38,008	149,146	46,014	45,730	47,980	44,989	184,713	51,830	55,681	56,504	53,239	217,254
Interest expense and other	4,661	6,005	5,374	6,448	13,108	16,263	3,438	1,876	1,744	1,270	8,328	3,285	1,381	1,413	1,299	7,378	2,066	1,025	1,092	1,029	5,212
Investment losses (5)					10,000	126															
<b>EBT</b>	17,871	35,043	64,846	74,875	89,204	104,880	33,568	33,712	36,800	36,738	140,818	42,729	44,349	46,568	43,690	177,335	49,764	54,656	55,412	52,210	212,043
Income tax expense	8,274	12,615	23,993	29,201	36,921	41,952	13,427	13,485	14,720	14,695	56,327	17,092	17,739	18,627	17,476	70,934	19,906	21,863	22,165	20,884	84,817
Equity in loss of unconsolidated affiliate, net of tax (6,11)					14,074	5,626															
Add: Interest on 5% convertible debentures						933		987	983	1,003	2,973	1,356	1,011	1,045	1,041	4,453	1,427	1,062	1,097	1,093	4,679
<b>Net income - continuing operations</b>	9,597	22,428	40,853	45,674	52,283	63,861	20,141	21,214	23,063	23,046	87,464	26,993	27,620	28,985	27,256	110,854	31,285	33,855	34,344	32,420	131,904
<b>Earnings per share</b>	<b>\$0.20</b>	<b>\$0.44</b>	<b>\$0.74</b>	<b>\$0.83</b>	<b>\$0.96</b>	<b>\$1.12</b>	<b>\$0.34</b>	<b>\$0.34</b>	<b>\$0.36</b>	<b>\$0.36</b>	<b>\$1.40</b>	<b>\$0.42</b>	<b>\$0.43</b>	<b>\$0.45</b>	<b>\$0.42</b>	<b>\$1.71</b>	<b>\$0.48</b>	<b>\$0.52</b>	<b>\$0.53</b>	<b>\$0.50</b>	<b>\$2.03</b>
Diluted shares excl. adjustment for convertible debenture	47,626	50,446	55,488	54,892	54,370			59,866	60,927	60,813		61,453	61,514	61,576	61,638	61,545	61,699	61,761	61,823	61,884	61,792
Adjustment for convertible debenture								3,286	3,286	3,286		3,417	3,286	3,286	3,286	3,286	3,286	3,286	3,286	3,286	3,286
Weighted average s/o	47,626	50,446	55,488	54,892	54,370	56,185	58,974	63,152	64,213	64,099	62,610	64,870	64,800	64,862	64,924	64,831	64,985	65,047	65,109	65,170	65,078
Change in accounting principle (9)					375																
<b>Discontinued operations:</b>																					
Income (loss) from discontinued operations, net of tax (7)				2,129	(9,415)																
Loss on disposal of discontinued operations, net of tax (8)					(23,968)																
New stores	8	7	9	9	17	12	1	4	4	2	11	5	3	2	2	12	4	4	4	4	16
Acquired stores	24	2	6	5	3	-	3	-	-	-	3	-	-	-	-	-	-	-	-	-	-
Closed stores	2	1	-	-	-	-	3	-	-	-	3	-	-	-	-	-	-	-	-	-	-
Relocations	2	1	3	1	3	3	1	1	-	-	2	-	-	-	1	1	-	-	-	-	-
<b>Total stores @ end of period</b>	<b>68</b>	<b>75</b>	<b>87</b>	<b>100</b>	<b>117</b>	<b>126</b>	<b>126</b>	<b>129</b>	<b>133</b>	<b>135</b>	<b>135</b>	<b>140</b>	<b>143</b>	<b>145</b>	<b>146</b>	<b>146</b>	<b>150</b>	<b>154</b>	<b>158</b>	<b>162</b>	<b>162</b>
<b>Comp. Store Growth</b>	<b>5.4%</b>	<b>8.3%</b>	<b>11.0%</b>	<b>7.7%</b>	<b>8.5%</b>	<b>9.2%</b>	<b>9.4%</b>	<b>10.1%</b>	<b>10.5%</b>	<b>10.5%</b>	<b>10.1%</b>	<b>10.5%</b>	<b>9.0%</b>	<b>8.0%</b>	<b>8.0%</b>	<b>9.0%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.3%</b>	<b>7.0%</b>	<b>7.3%</b>
2-Year Average Comps		6.9%	9.7%	9.4%	8.1%	8.8%	8.4%	9.9%	10.3%	10.4%	9.6%	10.0%	9.6%	9.3%	9.3%	9.5%	9.0%	8.3%	7.7%	7.5%	8.1%
<b>Growth Rate</b>																					
Net sales		17.6%	24.7%	14.1%	23.2%	23.6%	21.3%	20.5%	21.1%	10.7%	18.4%	18.3%	18.3%	16.3%	15.5%	17.2%	14.1%	13.7%	14.3%	15.6%	14.4%
Income from operations		82.2%	71.1%	15.8%	25.8%	18.4%	22.0%	22.1%	26.6%	21.8%	23.1%	24.3%	28.5%	24.5%	18.4%	23.8%	12.6%	21.8%	17.8%	18.3%	17.6%
Net income		133.7%	82.2%	11.8%	14.5%	22.1%	33.9%	41.0%	35.2%	37.8%	37.0%	34.0%	30.2%	25.7%	18.3%	26.7%	15.9%	22.6%	18.5%	18.9%	19.0%
EPS		120.3%	65.8%	13.1%	15.4%	16.4%	26.5%	24.0%	25.1%	23.7%	24.8%	21.8%	26.9%	24.4%	16.8%	22.4%	15.7%	22.1%	18.0%	18.5%	18.6%
# of stores		10.3%	16.0%	14.9%	17.0%	7.7%	5.9%	6.6%	8.1%	7.1%	7.1%	11.1%	10.9%	9.0%	8.1%	8.1%	7.1%	7.7%	9.0%	11.0%	11.0%
<b>Margin / % of Sales Analysis</b>																					
COGS	68.7%	67.6%	67.0%	66.3%	65.5%	65.2%	66.1%	65.0%	65.1%	64.9%	65.3%	65.9%	65.0%	65.1%	64.8%	65.3%	66.1%	64.9%	65.0%	64.7%	65.2%
<b>Gross margin</b>	<b>31.3%</b>	<b>32.4%</b>	<b>33.0%</b>	<b>33.7%</b>	<b>34.5%</b>	<b>34.8%</b>	<b>33.9%</b>	<b>35.0%</b>	<b>34.9%</b>	<b>35.1%</b>	<b>34.7%</b>	<b>34.1%</b>	<b>35.0%</b>	<b>34.9%</b>	<b>35.2%</b>	<b>34.7%</b>	<b>33.9%</b>	<b>35.1%</b>	<b>35.0%</b>	<b>35.3%</b>	<b>34.8%</b>
Direct store expense		24.5%	24.0%	24.3%	25.0%	25.3%	25.3%	24.8%	24.9%	25.5%	25.1%	25.3%	24.8%	24.9%	25.4%	25.1%	25.1%	24.5%	24.6%	25.3%	24.9%
<b>Contribution margin</b>	<b>7.8%</b>	<b>9.0%</b>	<b>9.0%</b>	<b>9.4%</b>	<b>9.4%</b>	<b>9.5%</b>	<b>8.6%</b>	<b>10.3%</b>	<b>10.0%</b>	<b>9.6%</b>	<b>9.6%</b>	<b>8.8%</b>	<b>10.2%</b>	<b>10.1%</b>	<b>9.8%</b>	<b>9.7%</b>	<b>8.8%</b>	<b>10.6%</b>	<b>10.4%</b>	<b>10.0%</b>	<b>9.9%</b>
G&A	28.1%	3.2%	3.1%	3.4%	3.0%	3.5%	3.6%	3.7%	3.5%	3.4%	3.6%	3.4%	3.7%	3.5%	3.4%	3.5%	3.6%	3.6%	3.5%	3.4%	3.5%
Pre-opening expense	0.7%	0.5%	0.3%	0.4%	0.6%	0.4%	0.3%	0.9%	0.5%	0.2%	0.5%	0.4%	0.3%	0.2%	0.3%	0.3%	0.3%	0.4%	0.3%	0.4%	0.3%
Amortization expense		0.2%	0.2%	0.2%	0.2%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Operating margin</b>	<b>2.5%</b>	<b>3.9%</b>	<b>5.4%</b>	<b>5.5%</b>	<b>5.6%</b>	<b>5.3%</b>	<b>4.7%</b>	<b>5.7%</b>	<b>5.9%</b>	<b>6.0%</b>	<b>5.5%</b>	<b>5.0%</b>	<b>6.2%</b>	<b>6.4%</b>	<b>6.1%</b>	<b>5.9%</b>	<b>4.9%</b>	<b>6.6%</b>	<b>6.6%</b>	<b>6.2%</b>	<b>6.0%</b>
Tax rate	46.3%	36.0%	37.0%	39.0%	41.4%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
<b>Net margin</b>	<b>1.1%</b>	<b>2.1%</b>	<b>3.1%</b>	<b>3.1%</b>	<b>2.8%</b>	<b>2.8%</b>	<b>2.6%</b>	<b>3.4%</b>	<b>3.6%</b>	<b>3.6%</b>	<b>3.3%</b>	<b>2.9%</b>	<b>3.7%</b>	<b>3.8%</b>	<b>3.7%</b>	<b>3.5%</b>	<b>3.0%</b>	<b>4.0%</b>	<b>4.0%</b>	<b>3.8%</b>	<b>3.7%</b>

Source: Company reports and RBC CM estimates

**Notes:**

- Direct store expenses are estimated based on the difference between gross profit and store contribution. The inclusion of non-store revenue could cause direct store expenses to vary from actual results
- Non-recurring charges in FY-97 relate to Amrion merger
- Non-recurring charges in FY-98 relate to Fresh Fields and Allegro coffee mergers
- Non-recurring charge from the disposal of assets (software and hardware)
- Reflects write-off of Whole Foods' investment in American WholeHealth
- Reflects Amrion's write-off of American WholeHealth and Real Goods
- Reflects Amrion's losses, net of tax
- Reflects the disposal of Amrion assets, less the tax benefit and net of estimated realizable value
- Reflects change in accounting principle for treatment of pre-opening expense (expensed as incurred)
- Q4-01 non-cash charge from three store closures.
- Q4-01 write-down of ownership in Gaiam.com