

**STRATEGIC REPORT FOR
WHOLE FOODS MARKET, INC.**

GOTHAM
GLOBAL.

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EXECUTIVE SUMMARY

Whole Foods Market Inc. (WFMI), entered the Natural Products Industry in 1980 and completed their initial public offering in January, 1992. WFMI and its subsidiaries engage in the ownership and operation of natural and organic foods supermarkets. The Company offers produce, seafood, grocery, meat, poultry, bakery, prepared foods, and catering. Today, WFMI is the largest food retailer of natural and organic products. WFMI is classified under Grocery Stores; however, the Company operates in one reportable segment, the natural foods supermarkets.

The Natural Products Industry is a fast growing segment of the market such that sales of natural products across all retail and direct-to consumer channels grew to \$51 billion in 2005, a 9% increase over the prior year.¹ The general populace has heightened awareness of the role that food and nutrition play in long-term health, causing consumers to turn towards natural and organic products. Supermarkets are fighting against this trend by adding natural and organic fare to their product mix. WFMI now competes on three fronts: natural and organic providers, traditional grocers, and big box retailers.

The main strategic issue facing WFMI today is competition, and how to grow the business fast enough to take advantage of a wider acceptance by the general populace. This report focuses on three strategies for the Company to encourage high growth rates including: differentiating stores and brand image, new store openings and acquisitions of smaller chains.

The first issue facing WFMI is determining how to carve a niche within the industry to gain market share. WFMI needs to balance the convenience needs of busy consumers with maintaining the integrity and image of natural and organic foods. Gotham Global recommends that the Company adopt multiple store models, concentrate on creating a unique environment, maintain flexible prices, and focus on the Company's private labels to ensure a positive life-style brand

image.

The second strategic issue facing WFMI is the ability to maintain rapid expansion. The two approaches to fast expansion are either opening new stores quickly and efficiently, or acquiring smaller chains. Gotham Global recommends that WFMI concentrate on successfully integrating the most recent acquisition, Wild Oats Markets into their company. At the same time, WFMI should find prime real estate to best utilize their large format stores and look to acquire new smaller chains, in particular Trader Joe's.

COMPANY BACKGROUND

Whole Foods Market, Inc. (WFMI) owns and operates the largest chain of natural and organic food stores. The Company mission is to promote the vitality and well-being of all individuals by supplying the highest quality and most wholesome foods available. WFMI is a mission driven company devoted to the promotion of organically grown foods, food safety concern, and sustainability of our entire eco-system. WFMI's mission stems from the belief that our food and the health of our bodies are directly related to the purity and health of our environment. The growth of WFMI has positively contributed to the natural and organic foods movement throughout the United States over the last 25 years.

WFMI is a Texas corporation, incorporated in 1980. The Company is based in Austin, Texas and conducts business through various wholly-owned subsidiaries. John Mackey, Renee Hardy, Craig Weller, and Mark Skiles founded WFMI after recognizing that the natural foods industry was ready for a supermarket format. WFMI operates in one reportable segment, natural and organic foods supermarkets. The Company opened their first store in Austin, Texas in 1980 with a staff of only 19 individuals. When WFMI first opened its doors there were less than a half a dozen natural food supermarkets in the United States.

In 1984, WFMI began to expand out of Austin by opening stores in Houston, Dallas, and New Orleans. The Company fueled rapid growth by acquiring other natural foods chains throughout the 1990's including: Wellspring Grocery of North Carolina, Bread & Circus of Massachusetts and Rhode Island, Mrs. Gooch's Natural Foods Market of Los Angeles, Bread of Life of Northern California, Fresh Fields Markets on the East Coast and in the Midwest, Florida Bread of Life stores, and Nature's Heartland of Boston. They continued their history of acquisitions with Food for Thought in Northern California and Harry's Farmers Market stores in Atlanta. Following WFMI's expansion into Canada in 2002, they entered the United Kingdom with the acquisition of seven Fresh and Wild stores.

Much of WFMI's growth has been accomplished through mergers and acquisitions. The history of the company is incomplete without recognizing these companies. Wellspring Grocery opened its doors in 1981 offering high quality and great nutrition to their consumers encouraging customers to be more connected with the food they ate. Mrs. Gooch's was founded by Sandy Gooch who became interested in natural foods after suffering severe allergic reactions to antibiotics and chemical additives in food. Mrs. Gooch's held its suppliers to high standards including no harmful chemicals or preservatives, no artificial colors or flavorings, and no white flour, refined sugar, alcohol, caffeine or chocolate. The company helped fuel demand for natural foods in southern California. These are just two examples of companies who have influenced the development of the Company.

WFMI's expansion has increased the need for products and processing plants. To help fuel this demand, the company added its 365 Everyday Value product line and purchased Allegro Coffee Company in 1997. A seafood processing plant was opened in Atlanta in 2003, the same year WFMI became United States' first national "certified organic" grocer. Now in 2007, the Company has announced their acquisition of Wild Oats Markets, a competing natural/organic food retailer based in Colorado. Pending stockholder and government approval, the transaction is expected to close in April. Wild Oats Markets operates under 4

names: Wild Oats Marketplace, Henry's Farmers Market, Sun Harvest and Capers Community Market.

As of today, WFMI has 196 locations in North America and the United Kingdom. They have 9 distribution centers and 39,000 employees. In 2005, they operated 175 stores: 165 stores in 30 U.S. states and the District of Columbia; three stores in Canada; and seven stores in the United Kingdom. Their sales have grown rapidly through new store openings, acquisitions and comparable store sales growth, from approximately \$92 million in fiscal year 1991, excluding the effect of pooling-of-interests transactions completed since 1991, to approximately \$4.7 billion in fiscal year 2005, a compounded annual growth rate of approximately 32%. John Mackey is currently the Chairman of the Board, Chief Executive Officer.

WFMI is a Fortune 500 Company, ranking 479 based on our fiscal year 2004 sales of \$3.9 billion. In 2007, Whole Foods Market was ranked as the 5th in Fortune magazine's annual list of the "100 Best Companies to Work For".ⁱⁱ The Company's stores average approximately 33,000 square feet in size and approximately \$28 million in annual sales. The stores are supported by regional distribution centers, bake house facilities, commissary kitchens, seafood-processing facilities, produce procurement centers and a coffee roasting operation.

One of WFMI's goals is to become an international brand synonymous with not just natural and organic foods, but with being the best food retailer in every community in which the Company is located. The Company places a heavy emphasis on perishable products which is helping to reach that goal. Their emphasis on perishable products differentiates WFMI's stores from conventional supermarkets and enables them to attract a broader customer base. Perishable product sales accounted for approximately 68% of their total retail sales in fiscal year 2005. The Company believes that all shoppers, not just natural and organic food shoppers, appreciate great produce, dairy, meat, seafood, bakery and

prepared foods, and it is Whole Foods Market's strength of execution in perishables that has attracted many of their most loyal customers.

COMPETITIVE ANALYSIS

WFMI is listed under Grocery Stores with an SIC Code of #5411 and specifically operates within the Natural Products Industry. The Company's product categories include, but are not limited to: produce, seafood, grocery, meat and poultry, bakery, prepared foods and catering, specialty (beer, wine and cheese), Whole Body (nutritional supplements, vitamins, body care and educational products such as books), floral, pet products and household products. WFMI faces competition from many sources including traditional grocers, big box retailers and pure rivals. Safeway and Kroger compete with WFMI as traditional grocers while Wal-Mart, Sam's Club, and Costco come at them as big box retailers. Finally, Wild Oats and Trader Joe's act as pure rivals in the market. The Company also competes with smaller chains and local farmer's markets.

INTERNAL RIVALRY

The Grocery Stores Industry is a mature market characterized by intense competition. WFMI is faced with constant competition within the vast food retailing industry. The Company falls under SIC code #5411 and operates within the Natural Products Industry. The competition varies from region to region as it includes local, regional, national and international conventional and specialty supermarkets, smaller specialty stores, and restaurants, each of which competes with the Company on the basis of product selection, quality, customer service, price or a combination of these factors.

Natural and organic food is one of the fastest growing segments of food retailing today. According to WFMI's 10k, the sales of natural products across all retail and direct-to-consumer channels grew to \$51 billion in 2005, a 9% increase over the prior year. The rapid growth in sales of natural and organic foods is being driven by numerous factors. To begin, within our society there is a heightened

awareness of the role that food and nutrition play in long-term health encouraging people to develop healthier eating patterns. The population has become better-educated and wealthier with an increasing median age. Finally, there has been an increasing consumer concern over the purity and safety of food due to the presence of pesticide residues, growth hormones, artificial ingredients and other chemicals, and genetically engineered ingredients. Thus, the price elasticity of demand for natural products is falling, making the market for Whole Foods more attractive.

WFMI is the largest food retailer of natural and organic products. The natural and organic products that the Company offers includes food and beverages, dietary supplements, personal care products, household goods, organic cotton clothing and related educational products. Natural foods are defined as “foods that are minimally processed, largely or completely free of artificial ingredients, preservatives and other non-naturally occurring chemicals and as near to their whole, natural state as possible”.ⁱⁱⁱ Organic products are grown through methods intended to support and enhance the earth’s natural balance. WFMI played an active leadership role in the development of the national organic standards. Margaret Wittenberg, the Vice President of Global Communications and Quality Standards at WFMI, served on the National Organic Standards Board from 1995 to 2000. As the sole retail representative, she contributed a broad, realistic perspective on how the standards could work most effectively at the retail level. The Company’s commitment to the promotion of organic agriculture and the integrity of the certified organic label is respected by consumers and encourages other companies within the industry to do the same. As a mission driven company, WFMI’s connection to organic standards attracts consumers and gives the Company a competitive edge.

The industry is characterized by rapid growth and increasing competition. Firms are constantly fighting to retain and increase market share. Historically, firms gained market share by operating in a niche market within the industry. Firms need to establish brand loyalty, differentiate themselves, and secure new

locations to maintain market share. As the market for natural and organic products becomes more mature, the produce and products provided by the firms are becoming more elastic with some consumers weighing the trade-off between price and quality. The main method to preserve market share is to provide high quality products at an affordable price. WFMI has responded by lowering prices on average by 3.9% over the last few years.

The big box retailers, Wal-Mart, Sam's Club and Costco have aggressively added natural and organic fare to their stores. This drastically increased competition within the industry and put downward pressure on pricing for other chains. Most traditional grocers, including Safeway and Kroger, now offer a limited selection of these products as well. WFMI has two avenues in which to respond to this increase in competition. The Company could either lower prices or further differentiate themselves as a high quality, value added supplier.

Another important approach for firms is to distinguish themselves within the industry with a clear mission and impeccable customer service. Advertising and marketing to promote positive image and product quality are essential as the consumers are determining market share through their purchasing decisions. WFMI spends less on advertising and marketing than conventional supermarkets. Approximately .4% of total sales in fiscal year 2006 went towards advertising and marketing. The Company relies primarily on word-of-mouth recommendations and testimonials from customers as well as the publicity and excitement generated by new store openings. Thus, there is opportunity for WFMI to expand on advertising and marketing to remain on the top.

There is also potential for growth for within the industry through mergers and acquisitions. WFMI intends to continue flourishing in this highly competitive industry by growing through new store openings. Because the natural foods retailing industry is highly fragmented and comprised of many smaller local and regional chains, they plan on acquiring smaller chains that provide access to

desirable markets, locations and experienced team members. At this time, WFMI is in the process of acquiring Wild Oats another natural and organic foods chain.

ENTRY

There are two main threats of entry for the Natural Products and Grocery Stores Industries. To begin with, there is a threat of new competitors entering the food retailing industry for the first time. There are low barriers to entry for these firms with low costs for acquiring agricultural products and perishable goods. The absence of technology in the industry also helps to keep start up costs low. On the other hand, existing companies in the Grocery Stores Industry have been in business for a significant amount of time and have established branding that would be hard to overcome for a new entrant. The largest barrier to entry for a new entrant would be the amount of money needed for advertising and marketing to gain market share by attracting consumers. Another barrier to entry is the ability to find and acquire solid real estate locations and have the capital to invest in the location. Although the Natural Products Industry has been experiencing rapid growth, there is still room for expansion within the industry. As this market is less mature there are even lower barriers to entry. It is important to note however, that new entrants are likely candidates for acquisition. Thus, it is always possible for WFMI to acquire new competitors before they grow large enough to be a threat.

The second threat for the Natural Products Industry comes from already established traditional grocers or big box retailers. There are no barriers to entry for these chains and/or stores to simply add organic and natural fare to their product mix. For example, the industry became highly competitive when companies such as Wal-Mart, Costco and Safeway aggressively added and advertised natural and organic products. However, now that most of the largest grocers and food retailers have natural and organic products in their stores it will be more difficult for new entrants to gain significant market share. As competitors are large and established they have the advantage of economies of scale and scope in production, marketing and distribution. Thus, they have the

power to retaliate against new entrants by reducing prices and taking short run losses to deter entry. Keep in mind that although big box retailers can start carrying organic produce, real entry into this market involves attracting the same customer base, not just selling organic products to their own customers. This implies that it is not simple for Wal-Mart to steal WFMI's market share as they have a stigma attached to them for being "cheap".

One of the central problems for established chains in the Natural Products Industry are low barriers to entry. With the want of technology within the food retailing industry, any company can enter and imitate WFMI's strategy and image. Acquisitions are common in the industry as a method of eliminating this risk.

SUBSTITUTES AND COMPLEMENTS

The first threat to WFMI is for customers to substitute the Company's products for their direct competitors such as Wild Oats or Trader Joe's. There is always the possibility for substituting away from WFMI to another natural products company. The low switching costs associated with WFMI is a threat to the Company's market share.

The Natural Products Industry operates with a higher degree of competition now that traditional grocers and big box retailers have entered the market by adding natural and organic fare to their product mix. Thus, there now exists the threat to WFMI of customers substituting away from the company's products to the less expensive natural and organic fare offered by stores similar to Safeway and Wal-Mart.

WFMI specializes in natural and organic products. When disposable income levels decline, customers may substitute away from the higher priced organic goods to the cheaper non-organic food items and products. Higher incomes benefit the Company more than traditional grocers illustrated by organic companies flourishing in high-income neighborhoods.

In the past couple of years, demand for organic fare has jumped with the health food craze. Organic and natural goods complement diets and health awareness. Any health food craze is a complement for WFMI which makes staying on top of organic regulations an important business strategy.

BUYER POWER

Companies like WFMI involved in packaging and marketing end-products in the organic industry typically have more value added through packaging and distribution than companies who merely process agribusiness commodities. As an organic grocer, WFMI sells its products to a large number of consumers with little buyer power. Collectively, however, the importance of catering to most buyers preferences means that WFMI must respond to changing demands made by the market as a whole in order to maintain its position of market leadership. For example, despite rising costs WFMI has lowered average product prices by 3.9% to compete more effectively with new entrants.

As demand for organic produce increases, WFMI may benefit from lower price elasticities than can be found in non-organic produce and groceries. Consumers do not always trust the authenticity of organic products sold in supermarkets. People have greater trust in the integrity of organic food sold through specialist and health food stores, and WFMI will be hoping to exploit this perception to its advantage.

SUPPLIER POWER

Again, WFMI's role as a final product merchant reflects greater value-added and larger producer-surplus. WFMI deals with suppliers for three of its own private labels— 365 Everyday Value, 365 Organic Everyday Value, and Whole Brands—as well as providing third-party produce and goods to keep shelves stocked.

WFMI purchases products for retail sale from local, regional and international wholesale suppliers and vendors. The majority of purchasing occurs at the regional and national levels enabling the Company to better negotiate volume

discounts with major vendors and distributors, while allowing the regional and store buyers to focus on local products and the unique product mix.

WFMI has a strong relationship and history with local farmers. The Company is committed to buying from local producers whose fruits and vegetables meet their high quality standards. WFMI currently purchases produce from over 2,400 different farms through various suppliers.

WFMI puts a heavy emphasis on perishable products to differentiate its stores from conventional supermarkets. Perishable product sales accounted for approximately 67% of total retail sales in 2006.^{iv} To the extent that WFMI is committed to dealing solely with local producers, those producers exert greater power of WFMI. Ironically, WFMI's explicit commitment to local produce is both an asset and a liability.

SWOT ANALYSIS

SWOT Analysis	
STRENGTHS	WEAKNESSES
<p>Leading player in a fast growing niche market</p> <p>Strong brand recognition and customer loyalty</p> <p>Large store format and purchasing power</p> <p>Current position of Wild Oats Markets stores</p>	<p>Overdependence on niche market</p> <p>Ability to sustain growth rates in established stores</p>
OPPORTUNITIES	THREATS
<p>Increasing concern for health and safe consumption</p> <p>Store expansion strategy to yield benefits</p>	<p>Competition in the food industry</p> <p>Issues related to labeling and health standards</p>

Strengths

Leading player in is a fast growing niche market

WFMI operates in the natural and organic foods segment, which is the fastest-growing segment of the retail-foods industry. The Company owns and operates the largest chain of natural and organic food stores. The Company has an advantage from the higher markup prices of natural foods than those of regular grocers. Thus, the Company is able to achieve more than average comparable store sales, as well as draw natural-food enthusiasts from traditional store formats.

Strong brand recognition and customer loyalty

WFMI enjoys strong brand recognition as a high-quality natural food retailer and retains a large base of regular customers. WFMI is a mission-driven company that aims to set the standards of excellence for food retailers. Their mission—Whole Foods, Whole People, Whole Planet—emphasizes their vision to reach far beyond just being a food retailer. By having a large assortment of natural and organic foods at reasonable prices and developing a value-added store environment, the Company built an image of being a lifestyle brand. WFMI's positive image helps grow and maintain the Company's loyal core of customers. As a result of their reliable customer base, WFMI has not needed to focus on their marketing efforts. Capitalizing on this strength the company's private label brands record equally good performance year after year, bringing incremental sales to the company.

Large store format and purchasing power

Another key strength of the company is its large size. Before their recent acquisition of their nearest competitor, WFMI was three times as large as Wild Oats Market. When the first store opened in Austin it had a square footage of 10,000 and was one of the largest natural foods stores in the country. Now, the company's average store size at drastically grown averaging to about 33,000 square feet. Besides increasing sales, the large store format enhances customer-shopping experience and produces higher store contribution profit. The Company also enjoys good purchasing power and is thereby able to leverage on economies of scale and pass on cost savings to its customers.

Current position of Wild Oats stores

The recent acquisition of Wild Oats Markets will strengthen WFMI's operating regions. All of the Company's 11 operating regions will gain stores, with three of its smaller regions gaining critical mass, and the company will gain immediate entry into a significant number of new markets. The acquisition will enhance Whole Foods' presence in the Pacific Northwest, Rocky Mountain and Florida regions. If the sale goes through, store closures and conversion of the remaining Wild Oats locations to the Whole Foods banner are expected.

Weaknesses

Overdependence on the niche market

The Company has a strong position in the natural foods markets; however, its presence has historically been restricted to this niche market. The sales and earnings of competitors in these markets are unpredictable and as a result, the company's stock prices are susceptible to high volatility. Furthermore, market fluctuations have affected the company's stock prices and volumes to a greater extent than its traditional peers. Despite posting a strong financial performance, the Company's credit worthiness remains questionable, as its presence is limited to such a highly specific market.

Inability to sustain growth through sales from current locations

WFMI is having trouble increasing same store sales. While this is problematic for the growth of the Company, this is a common problem in retail. Each store has a limited capacity for consumers at any given time. However, as most stores do not operate at capacity, WFMI needs strategies to convince a larger portion of the target demographic to shop at their stores.

Opportunities

Increasing concern for health and safe consumption among ageing baby boomers

The natural and organic foods segment is the fastest growing segment in the food retailing business. Growth in this segment is being further driven by the baby boomers' concern about purity of food and environmental safety related to water and soil quality. The fast growth in this industry has resulted in growth rates for the Company around 7% and this trend is expected to continue in the future.

WFMI can take advantage of this opportunity by expanding the image that the Company offers great food at great prices.^v

Store expansion strategy to yield benefits

Whole Foods Market has always included improving sales of its existing stores in their growth strategies. An important aspect of their growth strategy is add new stores to their retail network to expand. As of November 2, 2006, the company had signed leases for 88 stores scheduled to open through fiscal year 2010 totaling approximately 5.0 million square feet, or approximately 77% of their existing square footage.^{vi} Whole Foods Market concentrates on building new stores in urban areas where there is significant demand for organic and natural products. The company expects these new stores to have a larger average size which will help deliver strong returns over time as they appeal to a broader

customer base. Whole Foods Market has the opportunity to execute a disciplined, opportunistic real estate and acquisition strategy, by means of which it will be able to add new stores with significant square footage and are located on premium real estate sites.

Growth through acquisitions

Whole Foods Market concentrates on acquiring smaller stores that provide lucrative opportunities for sales expansions and enable it to become the dominant natural-food grocer in existing as well as new markets. The company has made 18 retail acquisitions in their history. Many of these acquisitions allowed Whole Foods Market to accelerate their geographic growth. In February of this year, the company announced that they were in the process of acquiring Wild Oats Markets, their closest competitor. Wild Oats Markets is one of the leading natural and organic foods retailers in North America. The company currently operates 110 stores in 24 states and British Columbia and Canada. Whole Foods Market expects to recognize significant synergies through G&A cost reductions, greater purchasing power, increased utilization of support facilities and new team member talent. Wild Oats Markets will be their largest acquisition, providing new opportunities for Whole Foods Market to grow. There is more room for acquisitions in WFMI's future.

Threats

Competition in the food industry

Although Whole Foods Market is one of the leading players in the natural foods segment, the company faces competition from traditional grocery stores. In addition, local, regional and national conventional and specialty supermarkets, smaller specialty stores and restaurants present competition, as they include at least a limited range of natural and organic food products. Being diverse product retailers, traditional grocery and other formats might be better equipped with

finance and market ability. Big box retailers and traditional grocers have added organic fare to their product mix, and several competitors such as Wal-Mart have a presence in more than one country. These newly competitive companies, in particular Wal-Mart, Costco, and Safeway, are putting downward pressure on the prices of natural and organic products. Whole Foods is also feeling pressure from niche retailers, especially the privately held Trader Joes and Wegmans. Highly time-pressed, young, professional consumers prefer the convenience and product range that a large supermarket provides. Whole Foods Market will need to balance the convenience needs of busy consumers with maintaining the integrity and image of natural and organic foods.

Issues related to labeling and health standards

Whole Foods Market operates in the natural and organic foods market which means its stores are subject to several laws and regulations regarding health and sanitation standards and food labeling. The various federal agencies include the Food and Drug Administration (FDA), the Federal Trade Commission (FTC), the Consumer Product Safety Commission (CPSC), the United States Department of Agriculture (USDA), and the Environmental Protection Agency (EPA) set several standards for manufacturing, processing, formulating, packaging, labeling, and advertising of products. Failure to comply with these standards could result in penalties and seizure of marketing and sales licensing.

Economic conditions to affect consumer spending patterns

The food retailing sector is relatively less affected by economic cycles. However, as Whole Foods Market specifically operates within the natural products industry they have prices that range higher than traditional grocery and food products. Higher costs associated with product development coupled with increased interest expenses may not allow the company to offer heavy discounts as its competitors during tight economic conditions. Thus, customers may shift

towards the less expensive alternatives when there is inadequate disposable income. This will most likely affect the company's growth and profitability.

FINANCIAL ISSUES

The acquisition of Wild Oats Markets may turn out to be a big positive for WFMI. At a transaction value of \$671m or 57% of sales on a trailing basis (\$565m market value plus \$106m assumed debt), the Company will be acquiring about 40% of its current square footage for just a little over 10% of its current enterprise value. We calculate that Wild Oats sales/sq. ft. productivity is at roughly half that of WFMI's and see little to prevent WFMI from bringing that up to its par.^{vii}

WFMI demonstrates execution process and sales productivity which translates into earning power. While it may take a couple of years to bring sales productivity to full WFMI levels, this equates to >30c EPS annualized earnings power. The added scale would also help fuel the competitive market-specific pricing investments management has discussed as a going forward plan.

On February 21, WFMI posted its first quarter financial results for fiscal 2007. The results were not stellar and could have sent the stock considerably lower if not for the news that WFMI and Wild Oats Markets were merging. While both these companies have been trailblazers in the industry, it seems need each other. They have been under considerable competitive pressure from traditional grocers and big box retailers like Wal-Mart.

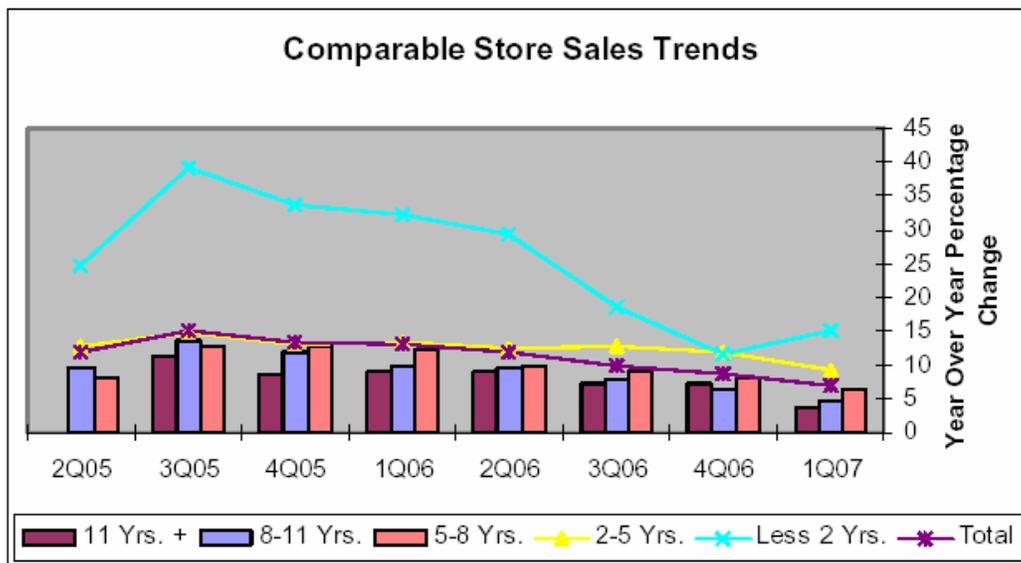
The Company's sales grew 12% to \$1.9 billion from stable comps growth of 7.0%, inline with expectations. However, earnings were not a bright spot for WFMI as they missed the Street's consensus estimate on the top and bottom lines. The Street was looking for revenue of \$1.89 billion and earnings per share of \$.41. The actual results were \$1.87 billion in revenues and earnings per share of \$.38. However, stock prices did rise as WFMI is addressing one of their biggest challenges, being able to expand at a faster rate.

Most of the positive trends for the Company's financials were seen on the balance sheet and cash flow statement as WFMI continued to struggle for footing the top line. The Company's trade accounts receivables edged lower to \$77.7 million from \$82.1 million in the last year. A large decrease in short-term cash offset higher inventories and prepaid expenses, which lowered working capital to \$65.2 million from \$114.2 million in the prior year period. The long-term debt declined to \$2.9 million from \$8.6 million while the total shareholder equity improved to \$1.45 billion from \$1.4 billion. The Company's cash from operations increased to \$112.4 million from \$88.2 million in the year ago period. Finally, the company's operation cash flow per share came in at \$.79 from \$.61 in the year period in part to few shares outstanding (142.9 million versus 145.3 million).^{viii}

On the flip side, the majority of the red flag developments are found in the income statement as management of the Company spent more to compete. The cost of goods sold edged higher to 65.75% of total revenue from 65.51% and free cash flow tumbled from \$52.9 million to \$11.5 million in one year. The cost of merchandise inventory increased to \$239.9 million from \$203.7 million or 17.8% year over year, which is a faster pace than total revenue improvements.

During the quarter, every category of stores saw sequential declines in comparable store sales, except those stores opened less than two-years illustrated in the two charts below.

Comparable Store Sales Details						
Period	11 Yrs. +	8-11 Yrs.	5-8 Yrs.	2-5 Yrs.	Less 2-Yrs.	Total
2Q05	NA	9.7	8.1	12.8	24.8	11.9
3Q05	11.3	13.6	12.7	14.7	39.1	15.2
4Q05	8.6	11.8	12.7	13.2	33.6	13.4
1Q06	9.1	10.0	12.2	13.3	32.3	13.0
2Q06	9.1	9.7	9.8	12.5	29.2	11.9
3Q06	7.4	7.8	8.9	12.8	18.6	9.9
4Q06	7.3	6.3	8.1	11.9	11.6	8.6
1Q07	3.8	4.6	6.5	9.3	15.2	7.0



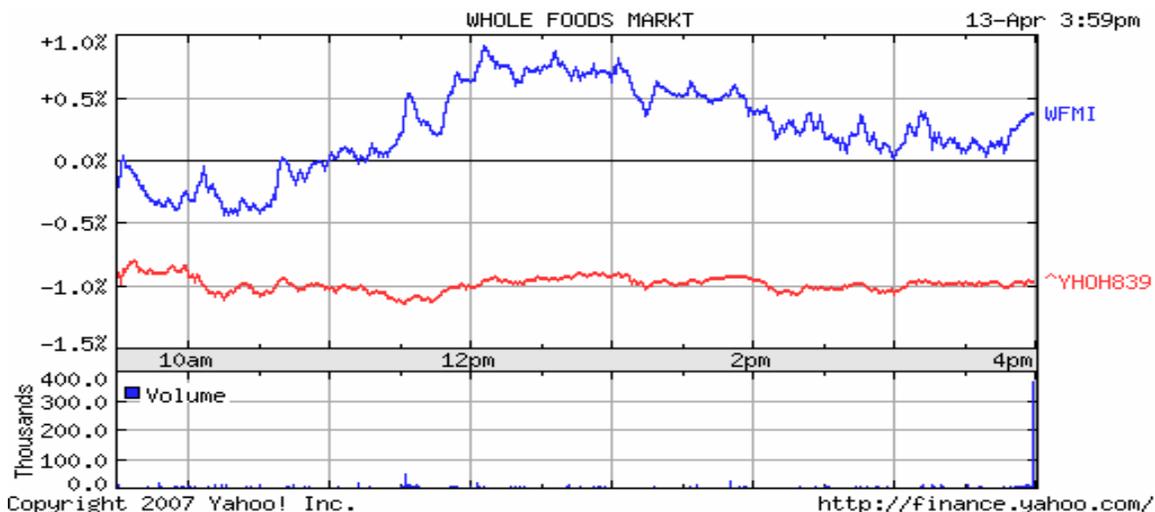
In Wall Street Strategies', *Update and Earnings Assessment Report*, the following financial estimates are projected for 2007:

Wall Street Strategies Financial Estimates		
Line Item	2Q07 Projection	2Q06 Actual
Revenue	1,509.8	1,311.5
Operating Income	86.5	82.3
Net Income	56.5	51.8
Earnings per Share	0.39	0.36

Wall Street Strategies Financial Estimates		
Line Item	FY07 Projection	FY06 Actual
Revenue	6,791.0	5,607.4
Operating Income	332.7	319.0
Net Income	211.1	203.8
Earnings per Share	1.52	1.41

All figures are in millions of U.S. dollars (except EPS)

One of the concerns facing Whole Foods Market is that other players are defining the organic space in the market. Trader Joe's has more locations, at 275 stores, and most Americans will learn about the niche from Wal-Mart and giant traditional grocers. The Company is not opening new stores fast enough to sustain the high growth rates the public expects. This may present an opportunity for management to re-think the super-giant store approach and focus on more stores. Whole Foods needs to deal with key issues close to its business model and this may cut into top and bottom line growth opportunities. In other words, the Company's business is slowing; however, the data is still attractive against large traditional grocers as illustrated by execution trends in the table below.



In this first graph, provided by Yahoo Finance, WFMI (blue trend line) is clearly outperforming the Grocery Industry (red trend line). The chart below compares WFMI to its traditional grocer competitors on valuation and execution. WFMI is clear ahead of the average traditional grocer in all four categories: price to earnings, price to sales, price to book, and price to cash flow. We also see that Wild Oats Markets are overall surpassing the average grocer while lagging behind WFMI. On the execution side, while WFMI has a higher same store sales percentage than Safeway or Kroger, the Company's gross margin is falling behind Safeway's.

Valuation

Company	Price to Earnings	Price to Sales	Price to Book	Price to Cash Flow
<i>WFMI</i>	33.02	1.18	4.62	18.41
<i>OATS</i>	32.90	0.40	3.49	11.44
<i>Traditional Grocers</i>	19.01	0.29	4.06	8.22

Execution

Company	% Sales Change Y/Y MRQ	Gross Margin	Operating Margin	Same-Store Sales MRQ
<i>WFMI</i>	12.22	25.81	4.57	7.0%
<i>SWY</i>	3.79	29.12	4.36	3.5%
<i>KR</i>	4.83	24.27	3.05	4.9%

When looking at the food-retailing industry, WFMI is still in a solid financial position. The Company's same store sales are above average and their margins are above their competitors. The recent acquisition of Wild Oats Market is a great opportunity to improve the financial status of WFMI. The Company needs to concentrate on expansion and growth to increase their earnings and improve the income statement.

STRATEGIC ISSUES AND RECOMMENDATIONS

The main strategic issue facing WFMI is competition from other suppliers, and the ability to accelerate growth to quickly expand the Company's consumer base. This report focuses on strategies that encourage the Company to grow quickly while sustaining and expanding the customer base.

The two key growth opportunities for WFMI are new store openings and acquisitions of smaller chains. Historically, the Company has opened or acquired

stores in existing regions, and in metropolitan areas in which it believes it can become the leading natural foods supermarket retailer. In developing new stores, WFMI seeks to open large format units located on premium sites, often in urban, highly populated areas. As of February 2007, WFMI had signed leases for 88 stores averaging approximately 56,000 square feet in size, which is more than 60% larger than its existing store base averages and shows a growing trend in the Company to even larger format supermarkets.

The recent trend towards small fresh food stores has not only heightened competition within the industry but also encroached on Whole Foods' market share. Trader Joe's has been very successful in recent years in slowly rolling out its small but highly productive specialty stores. Their stores are filled with exciting and low-cost products. While small, efficient fresh-food stores are the fastest growing format in the food retailing sector, WFMI continues to build bigger stores with larger browsing space and bigger counter space. If some margin business does transfer to other formats, these larger stores may prove expensive to run.

The Natural Products Industry is now characterized by a higher level of competition as the traditional supermarkets fight back. Over the past two years, the market has seen a rigorous effort by several supermarkets to improve the quality and breadth of their fresh food ranges. In particular, they have increased and improved their home meal replacements and improved and widened their organic selections. These additions have all come at lower prices than those offered by WFMI. Although there is still little overlap between a Whole Foods and a Wal-Mart shopper, even Wal-Mart has introduced organic fresh foods at selected stores. Wal-Mart has now set a low price point in product categories that hitherto had few price comparisons.

WFMI is facing a drastic increase in competition within the organic and natural foods market. With low barriers to entry, large supermarkets such as Wal-Mart and Safeway have added organic fare to their stores at lower prices while smaller

chains and local markets have flourished. The big-box retailers and traditional grocers have the ability to chip away at the Company's market share by pulling away those consumers whose switching price for organic fare is more elastic.

WFMI competes against the large grocers and big box retailers as well as the smaller specialty stores. Gotham Global recommends that WFMI utilize multiple store formats to face competition from all sides. With 88 new stores in the development pipeline, the Company should concentrate on a large store format when opening new stores. It is imperative that these large format stores be situated on key real estate. To successfully open new stores, these locations should be in densely populated areas that sustain a high demand for natural and organic products.

On the other hand, Gotham Global urges WFMI to also develop a smaller store format to directly compete with the smaller specialty stores in various geographic locations. While focusing on the larger store format for new store openings, the Company is capable of opening smaller stores by acquiring smaller chains to convert their smaller stores to the Whole Foods brand.

Consolidation could ease competitive pricing pressures in some markets, as well as improve operating profitability over the intermediate term for active participants by further leveraging overhead expenses over a greater number of stores. WFMI has made 18 retail acquisitions and is currently acquiring their closest competitor Wild Oats Markets. Mr. Mackey, Chairman of the Board said, "We think we are going to have a very positive impact on Wild Oats, and we think they will have a positive impact on Whole Foods, we need each other." ix

WFMI expects to recognize significant synergies through G&A cost reductions, greater purchasing power, increased utilization of support facilities and new team member talent. Gotham Global recommends that the Company evaluate each banner as well as each store to see how it fits into its overall brand and real estate strategy. Some of Wild Oats' stores will need to eventually be closed as well as

relocating some of the stores that overlap with stores that WFMI currently has in development. However, Gotham Global suggests integrating many of the stores into WFMI. Significant investments will be needed in remodeling stores before eventually re-branding them as WFMI stores. This plan carries less risk than opening large stores in new markets.

WFMI should continue looking for possible acquisitions within the industry. Mr. Mackey singled out Trader Joe's as a strong competitor. One reason that the Company sees Trader Joe's as a formidable rival is because the two grocers already serve many of the same higher-income consumers — the same customers who Wal-Mart has hoped to attract by adding organic foods. Gotham Global encourages WFMI to consider acquiring Trader Joe's. If acquiring Trader Joe's is a possibility, allowing stores to keep the Trader Joe's name could help expand WFMI's consumer base even further.

It is important to analyze the original allure of the Company to their consumer base. WFMI's success has not only been due to rising demand for natural and organic foods. Consumers are still utilizing conventional supermarkets; however, other formats have seen an increase of marginal sales as they may offer superior selection, price, quality or shopping environment.

Consumers have drifted towards WFMI because their stores offered a better shopping environment, high quality fresh foods, differentiated specialty products, excellent home meal replacement ideas and a wider organic selection compared to the conventional supermarkets. Although the Company set higher prices, the consumers decided they were worth the unique setting. Gotham Global recommends that WFMI capitalize on the value added aspects of their store environment. Focusing on product mix, store presentation, and customer service will make shopping at WFMI an experience worth paying a premium for.

WFMI also attracts customers with their strong mission to promote organic agriculture. The Company's motto, "Whole Foods, Whole People, Whole Planet,"

emphasizes the objective to reach beyond just food retailing. The Company's history and reputation are intimately linked to the Company's support of local farmers. Gotham Global suggests that WFMI increase their efforts in this regard by empowering individual store and regional buyers to seek out locally grown products. Another possibility would be for WFMI to set up a farmer's market in the parking lots at the large sites to further illustrate direct support of local farmers. This will help the Company's lifestyle image and possibly attract new consumers.

While consumers love WFMI's products and stores, there is a lingering resentment surrounding their prices. In response to the large supermarkets, the Company has been making an effort to get rid of their "whole paycheck" image and have lowered prices on average by 3.9%.^x This image may be undeserved as WFMI's product specifications are higher; shoppers now have cheaper alternatives to some of WFMI's products that were not previously there.

While lowering prices may appear to be a reasonable solution, it comes at a time when the company is investing heavily in accelerating its new store opening program—possible estimates on pre-opening expenses suggest that they may jump to \$72m this from \$37m last year.^{xi} Gotham Global cautions WFMI against competing directly against big box retailers. The Company should carve out their own market niche to compete within the industry without lowering their high-quality brand image by lowering prices.

One way to differentiate the Company from conventional supermarkets is by putting a heavy emphasis on perishable products. Perishable product sales accounted for approximately 67% of total retail sales in 2006. This is a crucial aspect of WFMI's stores and should continue to be a focus for the Company. Another aspect which helps differentiate WFMI's stores is the four private label brands that have been developed over the last few years. As of September 2006, private label sales in grocery and nutrition accounted for approximately 16% of total sales in those product categories. WFMI targets artisan food producers,

small batch production, and hand-tested recipes for products through their private label brands. The Company introduced the “365” label, used to sell everyday value products, as an alternative to more expensive branded products. WFMI also has the “Whole Kids Organic” label to target children and “365 Organic” label to provide organic foods at reduced prices. The Company should continue building these private labels to compete against the traditional grocer’s lower prices without lowering the Company’s high quality brand image.

Gotham Global believes private labeling is a key component of WFMI’s future success. Through private labeling, the Company is capable of reaching a wider range of consumers by targeting different income ranges with various private labels. WFMI has a loyal consumer base which results in the Company spending less on advertising than other competitors. To encourage the possible effects of private labeling, WFMI could increase marketing around the four private labels to reach more of the general populace.

The Company strives to differentiate its stores from those of its competitors by tailoring its product mix, customer service attitude, and store environment to appeal to health conscious and gourmet customers. Gotham Global recommends strategies to focus on differentiating stores through product and service offerings rather than low prices. Differentiating store offerings from low price competitors could result in an improvement of sales trends.

ⁱ Whole Foods Market, Inc. Form 10k, September 2006

ⁱⁱ CNNMoney.com, 100 Best Companies to Work For 2007

ⁱⁱⁱ Whole Foods Market, Inc. Form 10k, September 2006

^{iv} Whole Foods Market, Inc. Form 10k, September 2006

^v Datamonitor Company Spotlight, March 2004

^{vi} Whole Foods Market, Inc. Form 10k, September 2006

^{vii} UBS Investment Research, February 2007

^{viii} Wall Street Strategies: Update & Earnings Assessment Report 2007

^{ix} Whole Foods Market; www.wholefoods.investorinformation.com

^x Whole Foods Market, Inc. Form 10k, September 2006

^{xi} UBS Investment Research, February 2007