3D ADVISORS

This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
Governance: Corporate Governance Issues

Reduced Credit Facility and Insider Sales Coincide Whole Foods Market, Inc. (NASDAQ:WFMI)

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Whole Foods Market, Inc. owns and operates a chain of natural and organic foods supermarkets in the United States. As of September 29, 2002, the Company operated 135 stores in 25 states plus the District of Columbia and Canada. On average, the Company's stores carry approximately 26,000 stock-keeping units of food and non-food products. It offers a broad product selection with a heavy emphasis on perishable foods designed to appeal to both natural foods and gourmet shoppers. Its 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.

Summary of 3DAdvisors Findings for WFMI

- **Insider Trading:** Strong convergence of insider selling gets our attention
- **Accounting:** Reduced credit facility coincides with insider selling

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Discussion of 3DAdvisors Findings

Insider Trading: Strong convergence of insider selling gets our attention

Followers of Whole Foods Market (WFMI) were pretty rattled by the May 7th earnings release, which revealed poor same-store sales comparisons. More importantly, management significantly trimmed the second half revenue growth forecast, which really stirred the hornet's nest. Particularly interesting is the rather sloppy performance of the shares in the weeks after the announcement, a period during which the overall market remained very strong.

Clearly, Street players have become concerned about the suddenly stagnant growth prospects for Whole Foods. Before the announcement, and the guidance switch, believers were almost ubiquitous. Their presence seems now to be more difficult to spot.

It looks to us as if there are some serious doubts about the Company's growth prospects from the inside as well. First, there are sales by a number of key insiders before the announcement: **Lee Valkenaar (46)**, President of the Mid-Atlantic Region, has been at the company since 1987. He had not sold since May of 2000 (a small 568 share sale), until his recent sales of March of this year. On March 10th, he dropped 17,982 shares at $51.50 each. Though it's true that he had exercised options for 6,000 more shares than what he had sold, it should be noted that the options he exercised were done so at just $8.69 each. He certainly sold far more than he would have been required to in order to cover for the costs of the transaction.

Other sellers surfaced in March: **Glenda Flanagan**, CFO, dropped 6,000 shares in her first sale since August of 2001. Also selling was **John Mackey**, CEO, trimming just over 21,000 shares. This was his first sale since August of 2001 as well. A third seller prior to the news was **Walter Robb (49)**, Executive Vice President of West Coast Operations. He cleared out of 5,500 shares at prices in the $51 range between March 12th and 20th. There were two other sellers as well.

These seemingly prescient sales in themselves were not enough to grab our attention. It was the sales that surfaced *after* the announcement that raised our antennae, some by the same individuals who had sold in March and all after the shares had dropped almost ten points: Flanagan cleared out of an additional 8,000 of her shares at prices between $53 and $54. This was especially interesting as she had exercised for 16,000 in March but had only sold 6,000 of them. Since her exercise prices had been between $7.38 and $8.69 per share, she too (like Valkenaar) was selling far more than required in order to cover the costs of the exercise transactions.

There were others selling after the news: **Ron Megahan (32)**, President of the Northern Pacific Region dropped 4,700 shares (after exercising options for 4,398). Megahan had not sold a share, prior to this, since back in May of 2001. Megahan's case looks particularly interesting as it appears that he exercised every possible option he could on May 9th and sold them, plus most of his common holdings (he's still holding 191 shares). One of the options series he cleared out was 1,000 shares exercisable at $46.61 each, mysteriously close to the market price of the shares. By May 30th, Megahan saw options for another 5,000 shares vest. The following Monday, June 2nd, he sold those shares out as well for $55 each. That's an awful lot of sudden action from an insider who has been dormant for two years.

Then there was Walter Robb, the V.P. of West Coast Operations that had sold in March. Robb exercised options for 7,500 shares, on May 16th, and sold 10,500 on the same day at prices in the $53 range. Though Robb has surfaced at times to sell, in both 2001 and 2002, his sales took a noticeable jump with his last two rounds. A fourth seller, **David Lannon (36)**, President of the Northeast Region, dropped 6,406 shares at $53 each, his first sale since May of '02. **Michael Besancon (56)** is President of the Southern Pacific Region. He sold 3,500 shares, in May in the $54 range. This followed his 1,000-share sale, on March 13th, for $53.

<u>Accounting: Reduced credit facility coincides with insider sales</u>

These late March and May insider sales are interesting not only because of the convergence of the group and the fact that so many of them sold both before and *after* the announcement. A development, prior to those March sales, provides a possible clue that, before the release, these insiders saw problems on the growth front: On March 6th, just four days prior to the first March insider sale, the Company amended (four months early) its credit facility that was due to expire in July of '03. The point that jumps out at us is the fact that the facility was reduced from $220 million down to $100 million. The Company seems to position this development in a fashion that would indicate that they do not plan to use the facility in '03. However, we wonder about this. Giving up the flexibility of $120 million in readily available financing to save about $240K per year (the Commitment Fees are in the 0.25% range) does not seem like a prudent move, especially for a company that is in a growth mode. We wonder if this move may have been other-than-voluntary? This Facility had been built over the past four year period: From $100 million in 1999, amended to $160 million in February of 2000, amended again in March of 2001 to raise the limit to $220 million. Now the quick trimming?

The action just does not seem consistent with a company whose growth is dependent on the build-out of retail facilities (averaging $8.6 million per location plus another $750,000 for inventory per new store.). The first thing that occurs to us is whether they reduced the line of their own volition or rather at the behest of the lender. We find it interesting that, with a credit line reduction of this magnitude, they not only failed to file a related 8K but also failed to include any information on the amended Credit Facility as an attachment or footnote to any other disclosure.