ZACKS
INVESTMENT RESEARCH

3-Minute Manager Series

Using **ZRS** and the **Zacks Valuation Model** to identify factors impacting equity valuations in 3 minutes or less

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STARBUCKS & WHOLE FOODS MARKET: S&P 500 Laggards of 2014 ON THE Rebound IN 2015?

Starbucks & Whole Foods Markets: S&P 500 Laggards of 2014 on the Rebound in 2015?

Starbucks (Ticker: SBUX) and Whole Foods Market (Ticker: WFM) are two former ‘post-recession’ momentum names within the retail services space. On one hand you have Starbucks: the global roaster, marketer, and retailer of specialty coffee worldwide. On the other hand, you have Whole Foods: the largest purveyor of natural foods in the world.

Since February 28, 2009 through to the end of 2013, these two companies led retail services and the broader S&P 500 index. Aggressive global expansions, new product lines and operating margin efficiencies pushed these two retail service names to record highs in the November 2013 timeframe, since then both have lagged the performance of the S&P 500. How did two post-recession momentum names fall from grace toward the end of 2013? Was the performance of these two stocks simply the case of too far too fast or are there other factors in play here? What are these companies doing to boost equity valuations and bridge the performance gap relative to the S&P 500 in 2015?

These are questions that the Zacks Research System (ZRS) can help the user uncover, analyze and understand about the two companies. Whether the goal is attaining additional insight into complex business structures or evaluating current valuations and trends, ZRS offers all the necessary tools allowing users to explore analytical issues of relevance and make educated investment decisions.

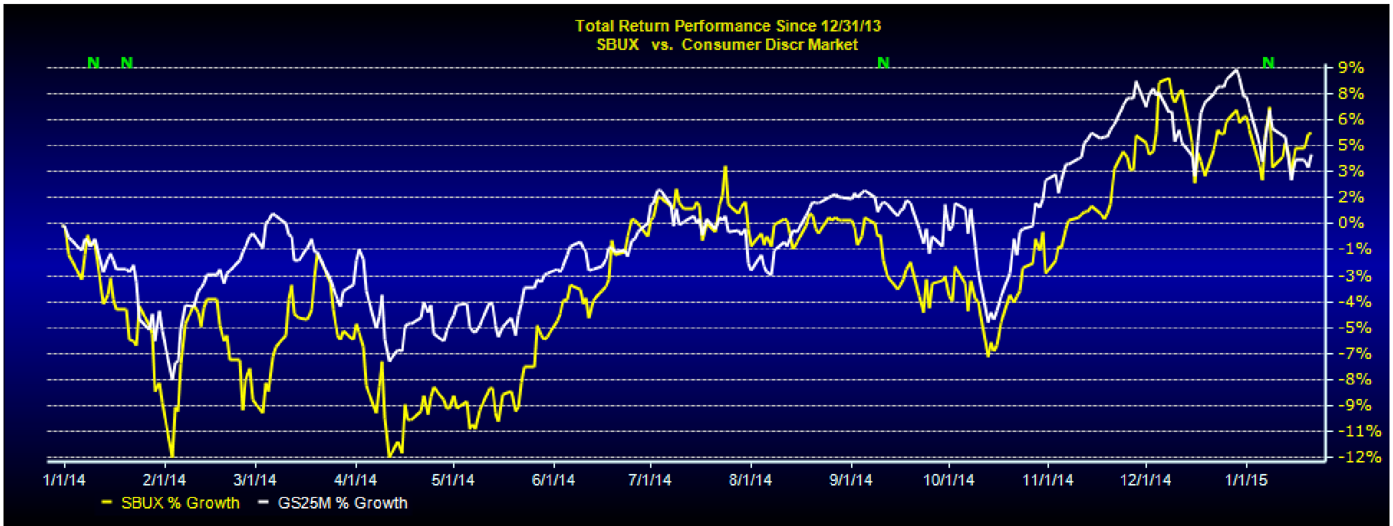
Let us begin with a broad view of the S&P 500 sector consumer staples, consumer discretionary and overall market performance since February 28, 2009 and then subsequently look at each firm’s relative performance over the same time period:

Title	HI	LO	MD	CU	CR	AR	SD	ED
S&P 500 Composite Market Price (Gr	175.7%	0%	80.1%	170.13%	171.2%	18.2%	02-28-2009	01-21-2015
S&P 500 Cons Discr Market Price (Gr	300.47%	0%	139.8%	285.21%	285.9%	25.3%	02-28-2009	01-21-2015
S&P 500 Cons Stapl Market Price (Gr	132.91%	0%	59.1%	132.91%	132.9%	15.2%	02-28-2009	01-21-2015
SBUX Price (Gr)	796.72%	0%	402.8%	788.42%	788.4%	44.1%	02-28-2009	01-21-2015
WFM Price (Gr)	939.18%	0%	529.3%	767.98%	768.0%	43.5%	02-28-2009	01-21-2015

Since February 28, 2009, Starbucks and Whole Foods has returned 788.4% and 768% respectively, more than double their respective S&P 500 sector group performance over the same time period.

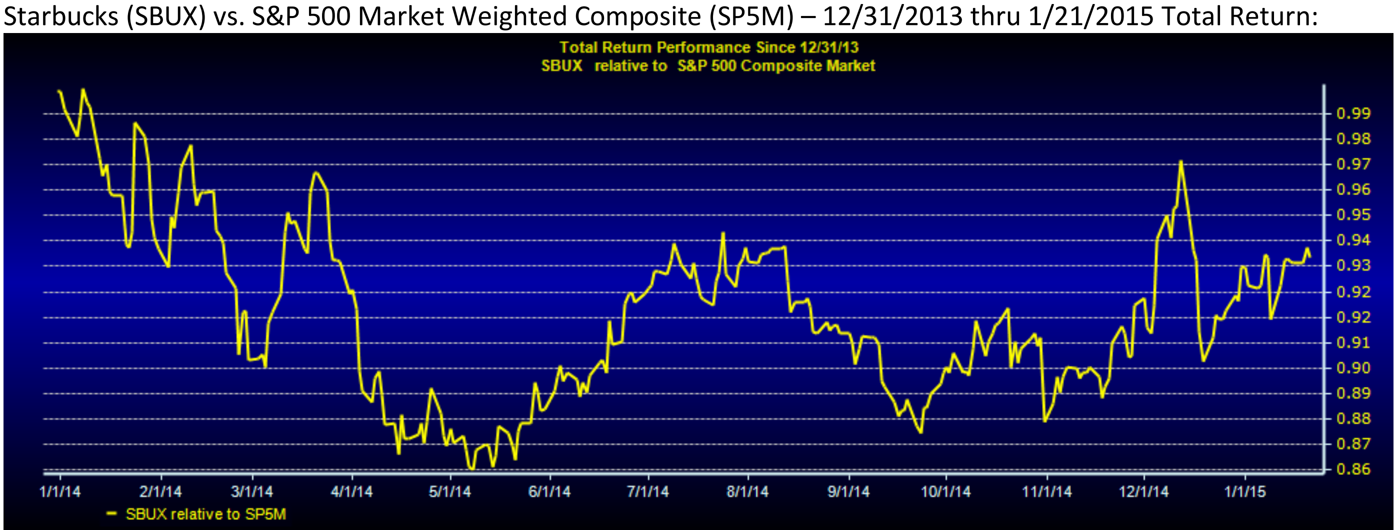
Let’s dig into the year to date absolute and relative performance of SBUX and WFM to their respective sectors and the S&P 500.

Starbucks (SBUX) vs. S&P 500 Market Weighted Consumer Discretionary Composite (SP5CDM) – 12/31/2013 thru 1/21/2015 Total Return:



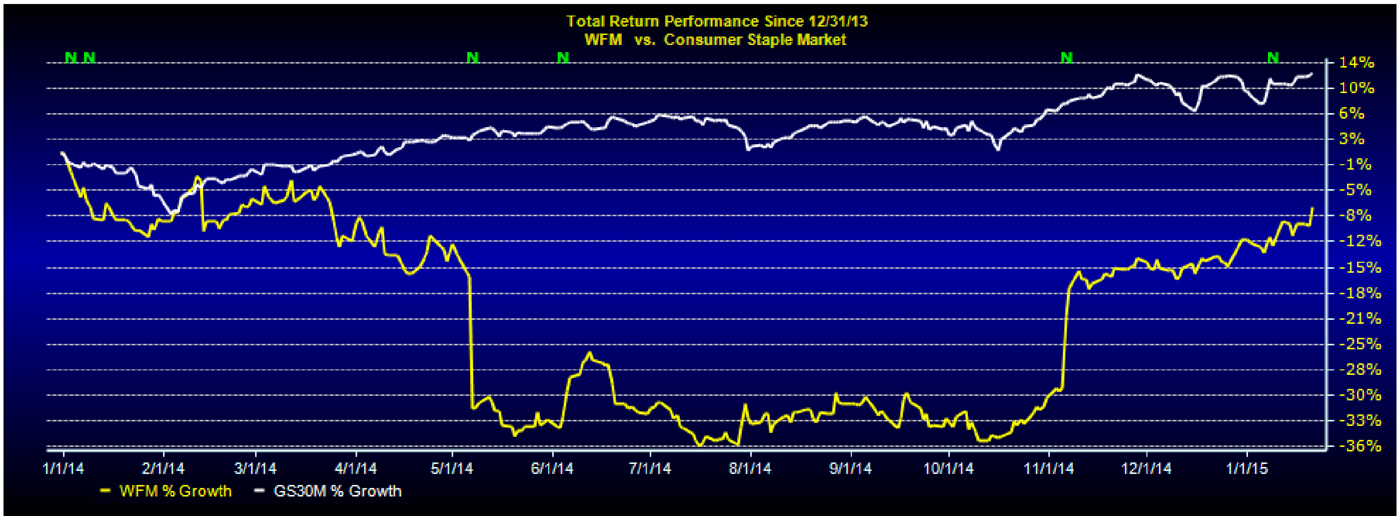
Title	HI	LO	MD	CU	CR	AR	SD	ED
SBUX % Gr	8.51%	-12.02%	-2.6%	5.26%	5.3%	5.0%	12-31-2013	01-21-2015
Consumer Discr Market % Gr	8.99%	-8.13%	-0.6%	4.07%	4.1%	3.8%	12-31-2013	01-21-2015

Starbucks (SBUX) vs. S&P 500 Market Weighted Composite (SP5M) – 12/31/2013 thru 1/21/2015 Total Return:



Title	HI	LO	MD	CU	SD	ED
SBUX relative to SP5M	1	0.86	0.91	0.94	12-31-2013	01-21-2015

Whole Foods (WFM) vs. S&P 500 Market Weighted Consumer Staples Composite (SP5CSM) – 12/31/2013 thru 1/21/2015 Total Return:



Title	HI	LO	MD	CU	CR	AR	SD	ED
WFM % Gr	0%	-36.47%	-16.8%	-7.6%	-7.6%	-7.2%	12-31-2013	01-21-2015
Consumer Staple Market % Gr	12.32%	-8.51%	3.7%	12.32%	12.3%	11.6%	12-31-2013	01-21-2015

Whole Foods (WFM) vs. S&P 500 Market Weighted Composite (SP5M) – YTD Total Return:

Title	HI	LO	MD	CU	SD	ED
WFM relative to SP5M	1	0.58	0.74	0.82	12-31-2013	01-21-2015

Even though both SBUX and WFM dominated performance during the post-recession period through to year end 2013, both lagged sector and broad market performance in 2014. The performance of WFM has been notably worse than that of SBUX relative to both benchmarks.

In a world of perpetual uncertainty that we have witnessed over the past five and a half years, there are many questions to be considered from the graphs above:

1) How are they valued currently? What are the material issues of analytical relevance, if any?
2) Which firm has more favorable future prospects over the next 3-5 years?

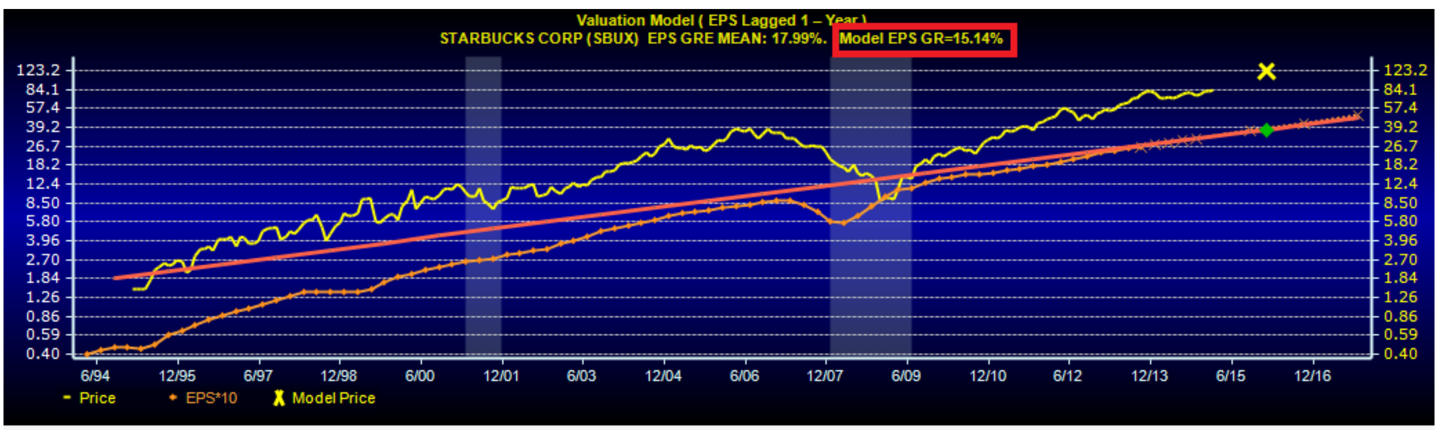
These questions provide a perfect opportunity to showcase how Zacks Research System (ZRS) and Zacks Valuation Model (ZVM) can be used to uncover the answers to the questions above in 3 minutes or less.

Zacks Valuation Model

The Zacks Valuation Model (ZVM) is a visually-oriented, five factor discounted earnings model that first appears in "default" mode. Default model inputs are derived exclusively from data contained within ZRS including sell-side consensus forecasts; no subjective adjustments to the data have been made by the Zacks analyst staff. Default results are objectively set with algorithms that generate the best possible starting point for analysis from which users are expected to provide overrides based on individual knowledge or forecasts of both company specific and macroeconomic factors. ZVM can quantify any combination of:

1) Earnings Forecasts
2) Earnings Growth Forecasts
3) Equity Risk Premium Forecasts
4) Interest Rate Forecasts
5) Company Specific Risk Issues.

So to begin the analysis, let us start with Starbucks to help the user understand the key inputs and items within the Zacks Valuation Model.



Zacks Valuation Model				Zacks Consensus Estimates				Normalized Earnings	
	Current	House	1-Year		2015	2016	2017	FYE: September	
Risk Free Rate (AAA)	3.46%	3.46 %	3.46%	Mean Estimate	3.13	3.68	4.31	2013	2.37
Equity Risk Premium	4.17%	4.17 %	4.17%	Change Y/Y	18%	18%	17%	2014	2.73
Company Specific Risk	0.00%	0.00 %	0.00%	High	3.20	3.80	4.51	2015	3.15
Total Equity Discount Rat	7.63%		7.63%	Low	3.10	3.57	4.20	2016	3.62
Actual PE F12M	25.05		22.13	Total	17	15	4	2017	4.17
Model PE F12M	32.93		32.93	#Up (4 weeks)	2	1	1	2018	4.80
Model Price	108.80		123.16	#Down (4 weeks	1	1	0	2019	5.53
Model EPS F12M	3.30		3.74	Mean Estimat	3.13	3.68	4.31	2020	6.37
Model Return	31.50%		50.40%	PE Intraday	28.1	23.9	20.4	2021	7.33

Save Model | Calculate | User Model

Chart Design:

○ Solid yellow line: SBUX Price History

○ Marked light orange line: SBUX Operating Earnings line (scaled by 10)

○ Red line: Normalized Earnings Line

Key Chart & Table Components:

○ *EPS GR MEAN*: Consensus mean growth rate forecast of long term earnings growth, normally 3-5 years

○ *Model EPS GR*: The long term consensus growth minus one standard deviation of the growth estimates, also equal to the slope of the earnings line

○ *Model Return*: Presented for Current & 1-Year Forecast (includes dividends):

- If the current Model Return is positive the stock is trading at a discount.
- If negative Model Return is displayed the stock is trading at a premium based on the model inputs.

○ 

(MIG button): Sets the Current Model Return to zero and solves for the resulting growth rate. Note that when Current Model Return equals zero the model is in equilibrium; the Model PE equals the Actual PE and the Model Price equals the Actual Price, resulting in a Model Implied Growth Rate (MET GR)

The ZVM is not a "Black Box" equity price generating tool, rather it is an exploratory tool through which analytical issues should be raised, researched and evaluated. The model will provide valuable results only when all default criteria has been analyzed, evaluated and overridden where necessary.

The above ZVM graph illustrates the basic model inputs:

• *Risk Free Rate* • *Equity Risk Premium* • *EPS F12M*

• *Company Specific Risk* • *Consensus Growth Rate Mean*

The above ZVM table illustrates the basic model outputs (for both Current and 1-Year forward)

• *Model PE F12M* • *Model Return* • *Model Price* • *Model EPS F12M*

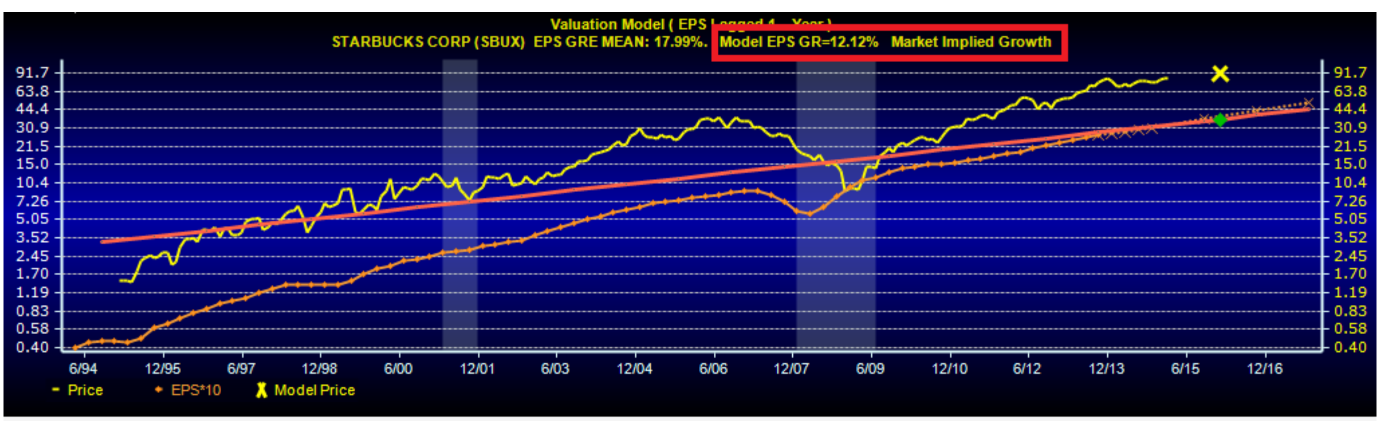
The slope of the Normalized Earnings Line above (solid red line) determines the growth rate of forward earnings, while the fulcrum of that line is the forward 12 months EPS target. ZVM, by default, sets the slope of the trend line as one standard deviation below the expected long-term earnings growth rate provided by a consensus forecast of analysts covering the company being evaluated.

Let us begin our analysis by reviewing the default model variables. Since our last review of SBUX in our August, 2014 paper, little has changed with regards to our conservative long term earnings growth forecast of 15.21% in August to 15.14% now in December, 2014. However, there have been notable changes in the other key inputs of the Zacks Valuation Model:

<u>ZVM Input Changes Since Last Update:</u>	1/2015	8/2014
Conservative Long-Term Earnings Growth Forecast	15.14%	15.21%
Model EPS F12M	$3.30	$3.08
Equity Risk Premium	4.17%	4.27%
Total Equity Discount Rate	7.63%	8.45%

It appears that Starbucks is considerably undervalued by virtue of its current Model Return of 31.50%. The ZVM model is telling us that if we expect sustainable and supportable earnings growth of 15.14%, then SBUX stock warrants a current price of $108.80. This represents a larger discount than our last update primarily attributable to the reduced equity risk premium, and hence the total discount rate. Based on this output alone, we need to consider why the current price is significantly lower than would otherwise be expected given the consensus sell-side growth forecast — the default model growth input. Could our consensus growth rates be different than what the market is using to price SBUX?

In order to unearth this information, let's assume the market is currently efficient, hold all other inputs constant and adjust the slope of the Model EPS GR line to arrive at a current Model Return of 0%. This will allow us to view the market's earnings growth rate expectation (i.e. Market Implied Growth Rate) based on the stock's current price. We are able to easily accomplish this by pressing the MIG button, which sets the current model return to 0%. One could also use the arrow tool right and left arrows to change the slope or growth rate.



Zacks Valuation Model				Zacks Consensus Estimates				Normalized Earnings	
	Current	House	1-Year		2015	2016	2017	FYE: September	
Risk Free Rate (AAA)	3.46%	3.46 %	3.46%	Mean Estimate	3.13	3.68	4.31	2013	2.53
Equity Risk Premium	4.17%	4.17 %	4.17%	Change Y/Y	18%	18%	17%	2014	2.83
Company Specific Risk	0.00%	0.00 %	0.00%	High	3.20	3.80	4.51	2015	3.18
Total Equity Discount Rat	7.63%		7.63%	Low	3.10	3.57	4.20	2016	3.56
Actual PE F12M	25.05		22.59	Total	17	15	4	2017	3.99
Model PE F12M	25.05		25.05	#Up (4 weeks)	2	1	1	2018	4.48
Model Price	82.74		91.68	#Down (4 weeks	1	1	0	2019	5.02
Model EPS F12M	3.30		3.66	Mean Estimat	3.13	3.68	4.31	2020	5.63
Model Return	0.00%		12.36%	PE Intraday	28.1	23.9	20.4	2021	6.31

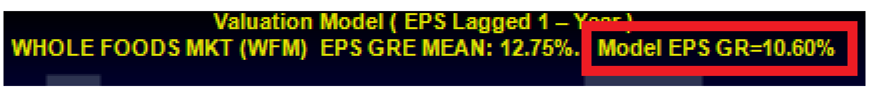
Save Model Calculate User Model

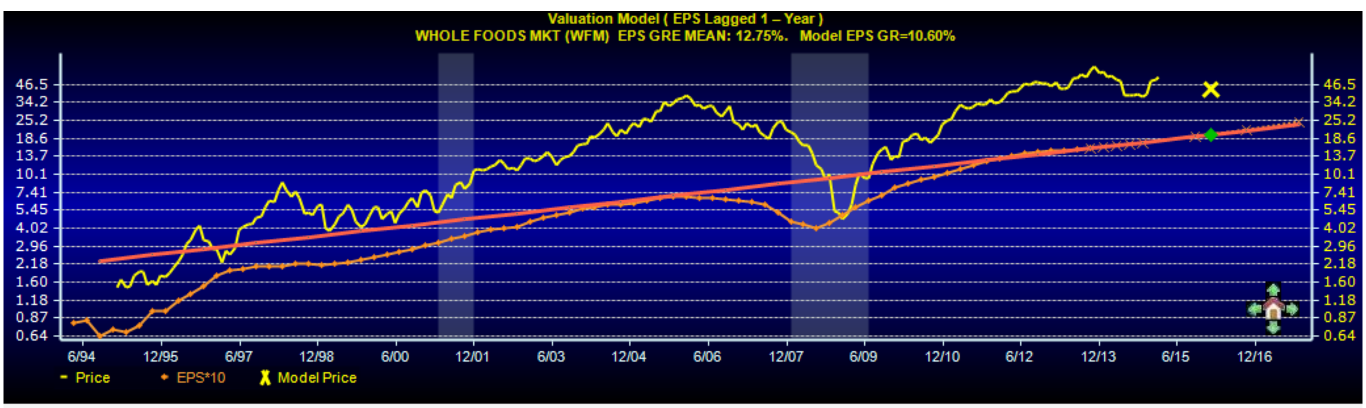
A summary of changes since our last update are presented in the following table:

	1/2015	8/2014
Market Implied Growth	12.12%	12.91%
Actual P/E F12M	25.05X	24.91X

Note that when the current Model Return is zero, the Model PE equals the Actual PE and the Model Price equals the Actual Price, resulting in a market implied growth rate. In essence, Model EPS GR now represents the long term growth rate at which the market (i.e. investment/buy-side community) is currently willing to pay for the stock. As we can see above, the current Market Implied Growth Rate of 12.12% is 328 basis points lower than conservative long term earnings growth estimate. Additionally, the MIG is now below our previously calculated hurdle rate of 12.91%. As our conservative long term earnings growth forecast has remained relatively unchanged while SBUX stock has slightly appreciated since our last paper, the buy-side community has effectively priced in less growth given the downward move in the equity risk premium. Based on the assumption that the market is in equilibrium at its current price level, one can infer that there is quite the disagreement between the sell-side community expectations and the implied valuations from the buy-side community, as quantified by the ZVM Market Implied Growth Rate.

But before we can make any more inferences for Starbucks, let's take a look at Whole Foods using the same steps that were described above. Below, in default mode the ZVM model is telling us that if we expect sustainable and supportable earnings growth of only 10.60%, based on the conservative sell-side EPS growth forecast, then WFM stock warrants a current price of only $39.21, this represents an overvaluation of 25.66% relative to current pricing levels.





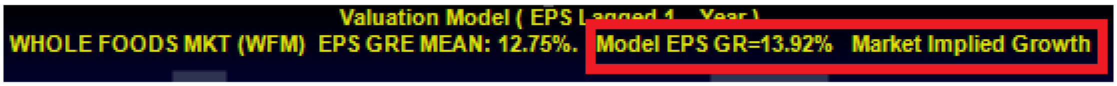
Zacks Valuation Model	Current	House	1-Year	Zacks Consensus Estimates	2015	2016	2017	Normalized Earnings FYE: September	
Risk Free Rate (AAA)	3.46%	3.46 %	3.46%	Mean Estimate	1.72	1.93	2.17	2013	1.41
Equity Risk Premium	4.17%	4.17 %	4.17%	Change Y/Y	11%	12%	12%	2014	1.56
Company Specific Risk	0.00%	0.00 %	0.00%	High	1.77	2.08	2.37	2015	1.73
Total Equity Discount Rat	7.63%		7.63%	Low	1.65	1.81	2.06	2016	1.91
Actual PE F12M	29.47		26.87	Total	19	14	4	2017	2.12
Model PE F12M	21.91		21.91	#Up (4 weeks)	1	1	0	2018	2.34
Model Price	39.21		42.94	#Down (4 weeks	0	1	1	2019	2.59
Model EPS F12M	1.79		1.96	Mean Estimat	1.72	1.93	2.17	2020	2.86
Model Return	-25.66%		-17.60%	PE Intraday	30.9	27.5	24.5	2021	3.17

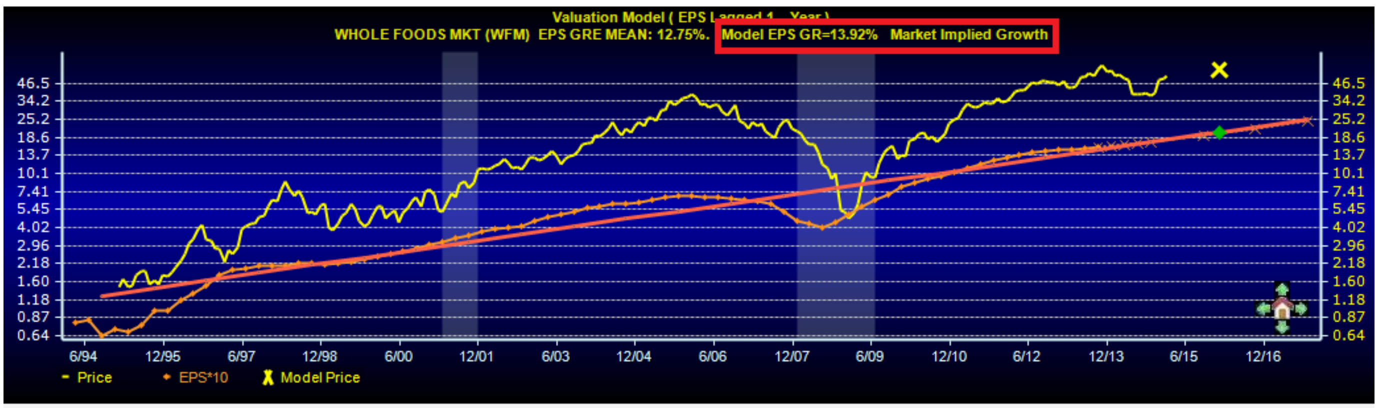
Save Model | Calculate | User Model

A summary of changes in the inputs of the Zacks Valuation Model for WFM since our last update is presented here:

	1/2015	8/2014
Conservative Long-Term Earnings Growth Forecast	10.60%	10.59%
Model EPS F12M	$1.79	$1.68
Equity Risk Premium	4.17%	4.27%
Total Equity Discount Rate	7.63%	8.45%
Model Return	-25.66%	-11.33%

Next, let us assume the market is currently in equilibrium and hold all other inputs constant while adjusting Model EPS GR to arrive at a current Model Return of 0%, through the use of the MIG button.





Zacks Valuation Model	Current	House	1-Year	Zacks Consensus Estimates	2015	2016	2017	Normalized Earnings FYE: September	
Risk Free Rate (AAA)	3.46%	3.46 %	3.46%	Mean Estimate	1.72	1.93	2.17	2013	1.32
Equity Risk Premium	4.17%	4.17 %	4.17%	Change Y/Y	11%	12%	12%	2014	1.50
Company Specific Risk	0.00%	0.00 %	0.00%	High	1.77	2.08	2.37	2015	1.71
Total Equity Discount Rat	7.63%		7.63%	Low	1.65	1.81	2.06	2016	1.95
Actual PE F12M	29.47		26.25	Total	19	14	4	2017	2.22
Model PE F12M	29.47		29.47	#Up (4 weeks)	1	1	0	2018	2.53
Model Price	52.75		59.23	#Down (4 weeks	0	1	1	2019	2.88
Model EPS F12M	1.79		2.01	Mean Estimat	1.72	1.93	2.17	2020	3.28
Model Return	0.00%		13.29%	PE Intraday	30.9	27.5	24.5	2021	3.74

Save Model | Calculate | User Model

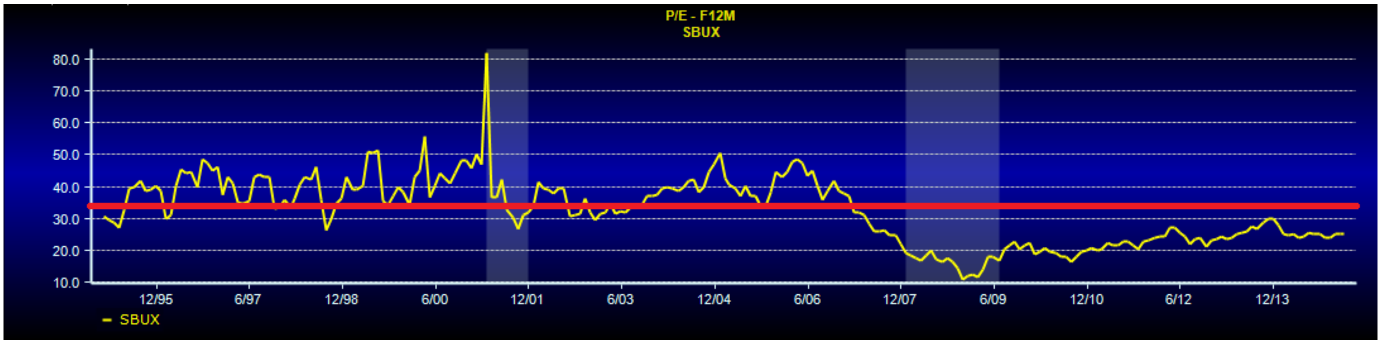
A summary of changes since our last update are presented in the following table:

	12/2014	8/2014
Market Implied Growth	13.92%	11.98%
Actual P/E F12M	29.47X	22.95X

Opposite of what we saw from SBUX, it appears that the buy-side community has actually bid-up Whole Foods to 13.92% growth from conservative default lows of 10.60%. There is a difference of 332 basis points between the current market implied growth rate and the conservative sell-side EPS growth estimate (i.e. Market Implied Growth of 13.92% vs. Model EPS GR of 10.60%), which represents a wider margin compared to our August, 2014 observation of 139 basis point spread.

Now we have come to a point where we have uncovered some interesting facts: 1) SBUX and WFM have underperformed their equal weighted sectors respectively as well as the equal weighted S&P 500 composite. 2) There is large dissonance in valuation between the market implied and the street for both stocks. 3) WFM is currently overvalued relative to default street consensus growth forecasts and SBUX is undervalued relative to default street consensus growth forecasts. These observations present us with the perfect opportunity to utilize the ZRS platform to investigate the merits of the disparity in valuation and the relative value prospects of the two stocks going forward.

To determine the viability of the default 'street' and market implied valuations, inputs and earnings growth forecasts, we need to first start by looking at a chart of historical forward PE's for Starbucks. For SBUX to be truly valued at 15.14% growth given current equity risk premium levels, the stock must attain a forward earnings multiple of 32.93X as indicated by the ZVM Model PE F12M.



Title	HI	LO	MD	CU	SD	ED
SBUX	81.81	10.88	33.14	25.05	01-31-1995	01-22-2015

Though historic PE multiples alone do not confirm the accuracy of ZVM's forecast, it does however provide us with a basis from which to compare current multiples and market conditions to historic multiples and market conditions.

Thus, looking at the historical Forward 12M PE chart above, it seems obvious that a multiple of 33X is achievable judging from the fact that SBUX has traded above that level for the majority of the pre-recession time period. However, the highest P/E achieved in the post-recession period was 30.60X. Comparing the actual forward PE of 25.05X, which is also well within historical range, it is worth noting that Starbucks would need to be valued at a long term sustainable and supportable growth rate of close to 15.14% to validate its current default 'street' valuation. This means that for price appreciation to be realized in the future, we need to find evidence of sustainable and supportable EPS growth greater than 15.14%. Is that possible?

In the case of Starbucks, to determine if the default street valuation in excess of its current actual valuation is attainable, we need to put the forward PE ratio into context. Specifically, we need to examine how SBUX multiples were affected by macroeconomic headline risk. We can do this by creating a **custom 1-4 Panel chart** within ZRS. The following four-panel chart (from top to bottom) includes PE F12M, Equity Risk Premium, Price Close and EPS BNRI.

As we can see from the four-panel chart above, Equity Risk Premium (ERP) has steadily increased over the past two decades due to heightened risk aversion, a direct result of an increase in macro-economic headline risk. Accordingly, notice that the ERP and PE multiples have a strong inverse relationship, i.e. as ERP increases PE decreases.

More importantly, it becomes apparent that SBUX's move upwards near the end of 2013 directly coincided with a noteworthy decrease in ERP giving way to PE multiple expansions for those stocks whose valuations are inversely correlated with changes in ERP. Specifically, we actually reached a forward earnings multiple of 30X in the November/December 2013 timeframe driven by a multiple expansion when ERP briefly dropped to the 3.5% level. It appears as though Starbucks can in fact be valued at a full 'street' 15% growth valuation but only in macroeconomic Equity Risk Premium environments of 3.5% or below. Now that the ERP has elevated above 4%, we broadly expect SBUX P/E multiples to remain subdued well below 30X.

In the case of Whole Foods, the buy-side community had already bid up the valuation in excess of conservative street EPS growth rate estimates at the time of writing our last paper in August. This validated forward earnings multiples in excess of what would otherwise be warranted by more conservative growth forecasts at the time in August. This excess valuation has only broadened since our last update.

Having recognized the large dissonance between the market implied valuation and the default street valuation for both stocks, the model has identified that each have roughly the same sustainable and supportable level of growth priced into their current valuations as indicated by the Market Implied Growth Rate for each stock. For Starbucks the sustainable and supportable level of growth to support its CURRENT valuation is the Market Implied Growth Rate of 12.12%. For WFM, this level of growth is 13.92%. In other words, at current levels of pricing, risk premium, risk free rate and EPS F12M, these levels are growth are currently being priced in terms of valuation. The Market Implied Growth Rates become our implied hurdle rates for any buy/sell decision.

We now know that the larger discount (conservative long term earnings forecast over market-implied growth) for SBUX since our last update was driven primarily by the decline in ERP. However, what drove the larger premium for WFM? Let's drill down into looking at growth and margins to determine what sustainable and supportable levels of growth really look like for SBUX and WFM to help answer this question.

Zacks Growth and Margin view allows one to focus in on short and long term diluted vs. aggregate growth in earnings and revenues. Incorporated into this view are year-over-year quarterly growth rates as well as sequential quarter-to-quarter growth rates in conjunction with EPS Surprise, Adjusted Net Margins and year-over-year quarterly share changes. This view allows the user to examine historical/forecast EARNINGS growth <u>sustainability</u> issues; while at the same time examine historical/forecast REVENUE growth <u>supportability</u> issues. Remember, you can only cut costs for so long before ***sustainable*** earnings growth must be ***supported*** by equivalent growth in revenues.

Growth and Margin

Starbucks Corp (SBUX)
1/23/2015 16:02:03 EST $88.02

Fiscal Year End: September
Next Expected Report Date: 04/23/2015

Quarter	REV Actual	REV Y-1	Q-T-Q REV %	Year Over Year Percent Change REV	RPS	EARN	EPS	EPS Actual	EPS Y-1	Q-T-Q EPS %	Net Mgn BNRI %	EPS Surprise %	Shares - Diluted Mil	Y-O-Y %
Mar 13	3,550	3,196	-6.4	11	13	19	20	0.48	0.40	-15.8	10.4	0.0	761	-1.6
Jun 13	3,735	3,304	5.2	13	15	25	28	0.55	0.43	14.6	11.2	3.8	762	-1.9
Sep 13 *	3,789	3,341	1.4	13	15	28	30	0.60	0.46	9.1	12.1	0.0	765	-1.2
Dec 13	4,240	3,793	11.9	12	11	25	25	0.71	0.57	18.3	12.8	2.9	766	0.6
Mar 14	3,874	3,550	-8.6	9	9	16	17	0.56	0.48	-21.1	11.0	0.0	765	0.4
Jun 14	4,154	3,735	7.2	11	11	23	22	0.67	0.55	19.6	12.3	1.5	761	-0.1
Sep 14 *	4,181	3,789	0.7	10	11	23	23	0.74	0.60	10.4	13.5	0.0	761	-0.5
Dec 14	4,803	4,240	14.9	13	15	12	13	0.80	0.71	8.1	12.6	0.0	755	-1.5
TTM	17,011	15,313	3.4	11	12	18	18	2.77	2.34	3.36	12.40			
Mar 15 E	4,495	3,874	-6.4	16	17	20	21	0.68	0.56	-15.1	11.4		757	-1.0
Jun 15 E	4,793	4,154	6.6	15	16	16	17	0.79	0.67	15.6	12.4		755	-0.8
Sep 15 E *	4,857	4,181	1.3	16	17	[illegible]	16	0.86	0.74	9.5	13.3		754	-0.9
Dec 15 E	5,442	4,803	12.1	13	14	20	20	0.96	0.80	11.9	13.3		752	-0.3
F4Q E	19,587	17,012	3.4	15	16	18	19	3.29	2.77	5.2	12.7			

Years	Least Square Growth Rates (%) REV	RPS	EARN	EPS	Point to Point Growth Rates (%) REV	RPS	EARN	EPS
1	12	11	23	23	11	12	18	18
3	11	12	22	23	12	12	21	21
5	12	12	20	[illegible]	11	11	23	23
10	10	10	17	18	12	[illegible]	17	18
15	15	15	20	20	16	16	22	22
20	20	19	24	23	22	19	27	24

Zacks Long Term Growth Rate Estimates (%)	
18.0	Mean Growth Rate Estimate
9	Number of Estimates
2.8	Standard Deviation
15.1	Default Growth Rate Estimate
12.12	Analyst Growth Rate Estimate

As Starbucks reported Q1 earnings on 1/22, we present key changes in growth rates since our August update:

	1/2015	8/2014
F4QE Revenues	15%	11%
F4QE Revenues per share	16%	11%
F4QE Earnings	18%	19%
F4QE Earnings per share	19%	20%

Glancing at the year-over-year (Y-O-Y %) growth estimates in the image above, we can see that the market implied growth rate for SBUX shown as the Analyst Growth Rate Estimate in the Growth and Margin view once the ZVM settings are saved at 12.12% looks to be well below the forecast revenue and earnings growth for the next 12 months, especially after their favorable earnings report sent sell-side analysts to revise upward their estimates for 2015. Even our previous market-implied growth forecast of 12.91% comes in below the new upward revised estimates for the next four quarters. However, from the above table, one can determine that the MIG is very biased towards the long term SUPPORTABILITY of revenue growth versus the high flying earnings growth of 17-20% that has been achieved through impeccable cost controls. Looking at the Shares Diluted column we can note that the capital structure is stable enough to observe diluted growth rates in the near term without the rates being distorted by share buyback or other capital structure changes. As such, notice how the market-implied growth of 12.12% falls squarely in line with longer term least squared growth rates highlighted on the bottom left corner of the above table. This further validates the trend that Starbucks is typically valued on long term SUPPORTABLE revenue growth versus long term earnings growth especially in times of commodity pricing pressures and elevated macroeconomic headline risk as measured by the Zacks ERP.

Now let's perform the same analysis for Whole Foods:

Growth and Margin

Whole Foods Mkt (WFM)
1/23/2015 16:20:56 EST $53.20

Fiscal Year End: September
Next Expected Report Date: 02/11/2015

Quarter	REV Actual	REV Y-1	Q-T-Q REV %	Year Over Year Percent Change REV	RPS	EARN	EPS	EPS Actual	EPS Y-1	Q-T-Q EPS %	Net Mgn BNRI %	EPS Surprise %	Shares - Diluted Mil	Y-O-Y %
Dec 12	3,856	3,391	32.5	14	10	23	20	0.39	0.33	30.0	3.8	1.3	374	3.1
Mar 13	3,027	2,670	-21.5	13	12	21	19	0.38	0.32	-2.6	4.7	4.1	374	1.2
Jun 13	3,058	2,727	1.0	12	11	22	21	0.38	0.32	0.0	4.6	2.7	375	0.7
Sep 13 *	2,976	2,911	-2.7	2	2	7	7	0.32	0.30	-15.8	4.1	3.2	376	0.7
Dec 13	4,239	3,856	42.4	10	9	8	8	0.42	0.39	31.3	3.7	-4.6	376	0.4
Mar 14	3,322	3,027	-21.6	10	10	0	0	0.38	0.38	-9.5	4.3	-7.3	375	0.2
Jun 14	3,377	3,058	1.7	10	13	6	8	0.41	0.38	7.9	4.5	5.1	367	-2.0
Sep 14 *	3,256	2,976	-3.6	9	13	6	9	0.35	0.32	-14.6	3.9	9.4	363	-3.5
TTM	14,194	12,917	2.0	10	11	5	6	1.56	1.47	1.96	4.08			
Dec 14 E	4,670	4,239	43.4	10	14	4	8	0.45	0.42	29.6	3.5		362	-3.6
Mar 15 E	3,688	3,322	-21.0	11	15	7	11	0.42	0.38	-7.3	4.1		361	-3.5
Jun 15 E	3,748	3,377	1.6	11	13	9	11	0.46	0.41	8.4	4.4		361	-1.7
Sep 15 E *	3,620	3,256	-3.4	11	12	11	11	0.39	0.35	-14.5	3.9		360	-0.7
F4Q E	15,726	14,194	2.4	11	14	8	10	1.72	1.56	2.4	4.0			

Years	Least Square Growth Rates (%) REV	RPS	EARN	EPS	Point to Point Growth Rates (%) REV	RPS	EARN	EPS
1	9	12	6	8	10	11	5	6
3	11	10	15	14	12	10	19	17
5	13	9	27	24	12	6	[illegible]	29
10	13	8	17	12	14	10	15	12
15	16	11	17	12	[illegible]	[illegible]	18	[illegible]
20	18	12	21	15	20	13	23	16

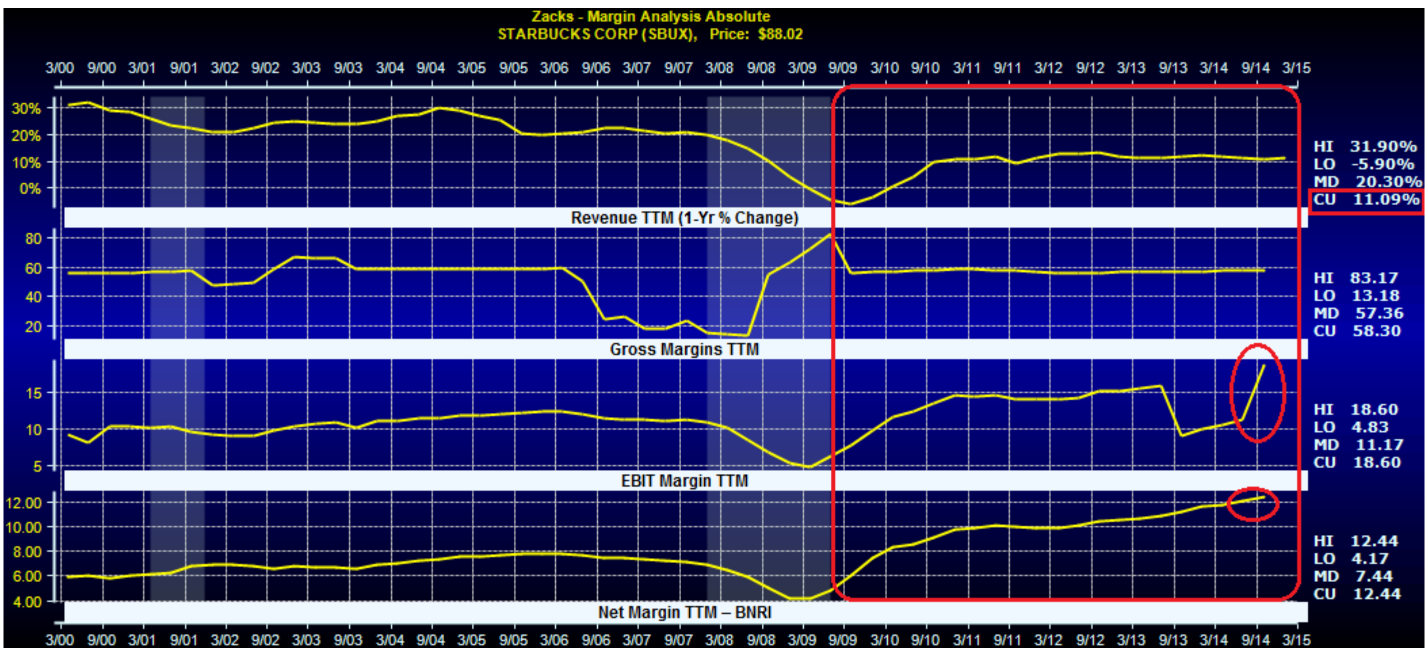
Zacks Long Term Growth Rate Estimates (%)	
12.7	Mean Growth Rate Estimate
8	Number of Estimates
2.1	Standard Deviation
10.6	Default Growth Rate Estimate
13.93	Analyst Growth Rate Estimate

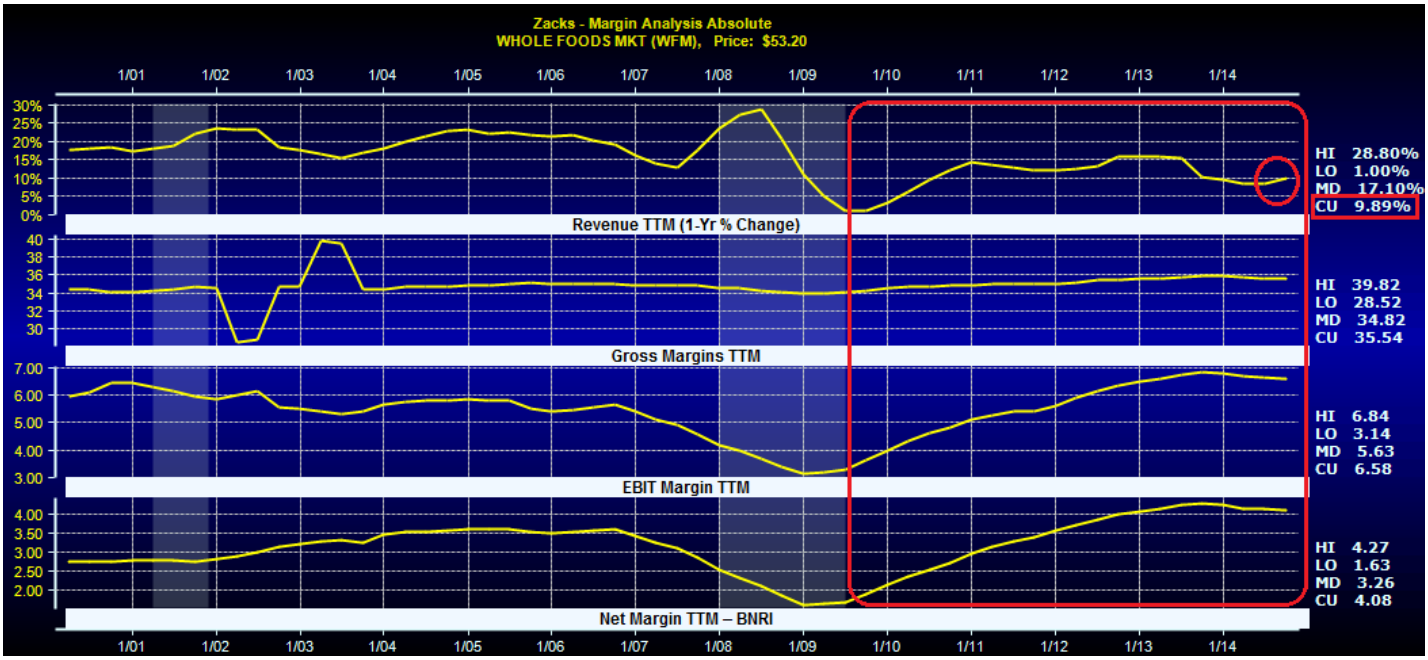
As Whole Foods reported Q4 earnings on 11/30, we present key changes in growth rates since our August update:

	1/2015	8/2014
F4QE Revenues	11%	11%
F4QE Revenues per share	14%	11%
F4QE Earnings	8%	7%
F4QE Earnings per share	10%	7%
Market-implied Growth	13.93%	11.98%

When looking at Whole Foods a different picture emerges quite rapidly. First, note that since its humble beginnings in 1980, Whole Foods has a strong history of growing by acquisition. Capital structure changes including changes in shares outstanding on a quarter to quarter basis make it difficult to do an apples-to-apples comparison of growth without looking at aggregate revenue and earnings growth rates. The Growth and Margin view supplies both. In WFM's case of share issuance in 2012 used to fund acquisitions and the like we will turn our attention to the more conservative aggregate revenue growth as a benchmark for valuations. Just as we saw in Starbucks, Whole Foods also appears to be valued on revenue growth with the buy-side community willing to look past the current earnings trough in anticipation of the gradual return to 13-14% revenue and earnings growth forecast through the December 2015 quarter. Again, just like we saw with Starbucks, long term least squared growth rates further validate the trend that Whole Foods is typically valued on its long term SUPPORTABLE levels of revenue growth versus long term earnings growth. Perhaps the answer to this lies in the fact that margins are typically cyclical over time? Let's dig a bit deeper into the issue of margins.

Looking at another Custom 4 Panel view, **Zacks -Margin Analysis Absolute** we can take a longer term view of the quarterly, year-over-year revenue growth rates and related margin rates to view the cyclical nature of each business. Since margins tend to be cyclical over the long-term, most analysis of these trends should be done by viewing at least 20 years of data. In the four panel charts below, we have defined the period of analysis to be 20 years so that we can take a look at what past and recent margin trends tell us about SBUX and WFM.





As Starbucks and Whole Foods both reported earnings since our last paper, and Starbucks just recently reported Q1 earnings on 1/22/2015, we summarize changes in margins and revenue growth here:

	Q4 2014	**Q2 2014**
WFM Revenue TTM Growth	9.89%	8.26%
WFM Gross Margin TTM	35.54%	35.58%
WFM EBIT Margin TTM	6.58%	6.66%
WFM Net Margin BNRI TTM	4.08%	4.11%
	Q1 2015	**Q3 2014**
SBUX Revenue TTM Growth	11.09%	10.64%
SBUX Gross Margin TTM	-	58.30%
SBUX EBIT Margin TTM	-	18.60%
SBUX Net Margin BNRI TTM	-	12.44%

From the images above, Starbucks' overall margins are superior on an absolute basis; but it is the individual trends of these ratios that are most informative and provide a better perspective of where each company is in their margin cycle.

Looking at Net Margin TTM – BNRI for both companies, which has been adjusted for non-operating one-time events, we see that these ratios have steadily increased more than two fold since the start of the economic recovery in 2009. The difference is that while both have been able to increase net margins, SBUX has been able to maintain a stable annual growth rate of revenues around 11% while WFM has been on the decline to roughly 8.25% annual growth as of the end of Q2, but has since reported strong Q3 sales growth which resulted in year-over-year growth of 9.89%. Although the rise in operating margins for SBUX is partly attributable to a recovery following the one-time litigation expenses the company incurred during the fiscal quarter-ended March 2014, the company is now achieving margins even higher than the previous highs set in 2013. Further analysis of the gross margins tells us that both companies have done well maintaining their input costs; however it is SBUX who has been able to sustain their operating and net margin growth. To the contrary, upon closer analysis of WFM, margins have peaked and are at risk of entering another cycle unless they can be either maintained or offset by a larger uptick in revenue growth.

In summary, let us recall some of the analytical issues of relevance we have found for both Starbucks and Whole Foods:

1) Starbucks - In ZVM default mode with sell-side 'street' consensus forecasts SBUX is considerably UNDERVALUED by virtue of its current Model Return of 31.50%. The ZVM model is telling us that if we expect sustainable and supportable earnings growth of 15.14%, then SBUX stock warrants a current price of $108.80.
2) Whole Foods - In ZVM default mode with sell-side 'street' consensus forecasts WFM is considerably OVERVALUED by virtue of its current Model Return of -25.66%. The ZVM model is telling us that if we expect sustainable and supportable earnings growth of only just as the sell-side is forecasting at 10.60%, then WFM stock warrants a current price of only $39.21.
3) Starbucks – Assuming the consensus EPS F12M earnings estimate of 3.30 is correct while holding all other model inputs constant, we were able to back into the long term market implied earnings growth forecast that sets the Current Model Return = 0, this sets the ZVM into equilibrium. This value for SBUX was 12.12% and was considered our hurdle rate of return.
4) Whole Foods – Assuming the consensus EPS F12M earnings estimate of 1.79 is correct while holding all other model inputs constant, we were able to back into the long term market implied earnings growth forecast that sets the Current Model Return = 0, this sets the ZVM into equilibrium. This value for WFM was 13.92% and was considered our hurdle rate of return.
5) Starbucks – Since the beginning of the economic recovery in 2009, SBUX has normalized/stabilized top line revenue growth to roughly 11% per annum while at the same time continuing to deliver on operating margin and net margin expansions all while keeping input costs in check. However, since our last update, revenue forecasts have been revised upward since management reported strong fiscal Q4 topline growth with lifted guidance for 2015. Additionally, SBUX margins appear to still be on an upward trajectory driven by superior SG&A cost control. This is expected to continue as input cost inflation remains subdued for the foreseeable future.
6) Whole Foods – Since the beginning of the economic recovery in 2009, WFM has failed to normalize/stabilize top line revenue growth but is potentially back on the upswing at 9.89% growth, while the buy-side community is pricing in 13.92% growth. WFM has been able to keep input costs in check, but appear to have hit a cyclical top in their EBIT and Net Margins. However, as suggested by the elevated market-implied growth, the buy-side community continues to be willing to look beyond these issues in anticipation of a resumption of trend revenue growth back toward 13-14%. Evidence of 14% revenue growth needs to be seen before the stock can be justified at its current levels and beyond.

Given our findings above in this very quick study it is apparent that that the buy-side and sell-side are at odds over valuations of each company and for different reasons. Using ZRS we have been able to identify several analytical issues of relevance impacting valuations in 3 minutes or less, all of which will be instrumental in guiding us in the appropriate direction for more in-depth analysis.

Starbucks – 10-11%+ revenue growth in 2014 accelerating to 16-18% in 2015 as per management's guidance, coupled with increasing revenue contribution coming from higher margin business. As commodity inflation expectations remain subdued for 2015, SBUX should continue to enjoy elevated margins, possibly even enough to offset a small slip in revenue growth. The buy-side is currently discounting Starbucks from a 'fully vetted' sell-side forecast growth valuation of 16% down to only 12.12% growth. The buy-side is effectively discounting the risk associated with consumer spending expectations and revenue growth, and the primary driver of this disparity is undoubtedly the uptick in our Equity Risk Premium (ERP) reading over the past quarter. In spite of this, as a result of the upward revisions in revenue estimates since our last update, we believe the buy-side is currently underappreciating the near-term realizable revenue growth, while appropriately discounting the higher earnings growth rates of 20+% which are subject to potential margin erosion at a moment's notice. In short, we believe the strongly upward revised revenue growth outlook for 2015, along with lower cost pressure and an uptick in operating cost control measures are all going to have a positive impact on forward earnings multiples.

Whole Foods – The bar is set high for a rebound in both revenue and earnings growth for WFM. The buy-side has already bid up the market implied growth rate for WFM in excess of the sell-side growth forecast. If WFM is not able to return back to at least 13.92% growth (as dictated by the market implied growth rate from ZVM) on both the top and bottom line in the intermediate term, valuations could be negatively impacted. Adding to this pressure is the fact that we know there is great risk of operating and net margins rolling over and this risk increases greatly with any slip in forecast revenue growth as well as any cost issues that may arise unexpectedly. Given the fact that the buy-side has priced in a full recovery in top line and bottom line growth back to 13.92% despite the most recent Q4 TTM revenue growth checking in at only 9.89%, there remains no margin for error allowed. We believe one should err on the side of caution and continue to evaluate WFM operating results in Q1 and Q2 2015 before taking a position in the stock. If Whole Foods is able to return to its longer term trend revenue growth of 13-14%, there may be an opportunity; however, as we can see from our analysis, WFM is already priced for perfection.

Tim Nyland, CFA
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Zacks Institutional Services

1/26/2015