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# Time to Bid Auf Wiedersehen

*A return to topics discussed in earlier issues.*

**Review | Preview**

**Whole Foods Still Looks Appetizing | Adidas' Upturn Still on Track**

**THE REASONS BEHIND THE SURPRISE RESIGNATION** Tuesday of **Volkswagen** CIAO Bernd Pischetsrieder, effective Dec. 31, are opaque. What's clear is that the previously sunny outlook for VW's shares has turned decidedly cloudy.

Neither VW nor **Porsche**, which owns 21% of the Wolfsburg-based company and options for 3.9% more, have provided details about the change. But Pischetsrieder's exit seems to have been orchestrated by Ferdinand Piech, VW's supervisory-board chairman and ex-CEO, whose family controls Porsche -- VW's biggest shareholder. Pischetsrieder will be replaced by Martin Winterkorn, a Piech protégé, and head of VW's premium Audi brand.

The outgoing CEO, whose contract was renewed just last May, has put VW through some painful but necessary restructuring changes, the fruits of which are just emerging. Third-quarter revenue rose 7% from the year-earlier total, to about 25.14 billion euros. Operating profit of €991 million beat forecasts, and, most important in this fiercely competitive global business, VW's profit margin hit 6%, triple its 2004 level. In the year's first nine months, vehicle sales rose 10%, to 4.2 million.

Erik Freeland/Corbis

The wheels could be about to come off Volkswagen's successful comeback strategy.

Such hefty margin expansion wasn't expected by the market 18 months ago, when *Barron's* expressed confidence that Pischetsrieder, with then newly hired VW brand head Wolfgang Bernhard, would revive the car maker (**"Turnaround Ahead at VW**," May 16, 2005.) Since then, VW's OTC-traded American depositary shares (ticker: VLKAY) have jumped to 20.40, from 8.60.

Is the changing-of-the guard a speed bump on the

way to better returns or an uncertain detour? Unfortunately, it's probably the latter. Piech, author of the late 1990s capital-expenditure spree that put VW into a hole, represents the bad old days, when spending big to develop a money-losing luxury model like the Phaeton was more important than cutting costs, and labor peace was more valued than efficiency and shareholder returns. This might be good for VW employees, but not for shareholders.

Secondly, VW's stock probably doesn't have much more to go, even in the unlikely event that the restructuring continues apace. VW's margins historically top out at 6%, and after their huge run-up, the shares trade above book value and about 30% of annual sales, both points typically the top of VW's historical trading range. The market has also factored in much of the potential restructuring improvement.

Meanwhile, Porsche is using capacity at VW, whose factories make some parts for the Cayenne SUV and will do the same for Porsche's new Panamera sedan. This lets Porsche (POR3.Frankfurt) avoid building a new factory -- good for its holders, not so good for VW's, who'd profit more if it were making its own cars, instead of acting as a subcontractor.

Given all this, the safest course is for shareholders to drive off with their profits and bid auf wiedersehen to VW shares.

-- *Vito J. Racanelli*

## *Whole Foods Still Looks Appetizing*

**INVESTORS SOURED ON WHOLE FOODS MARKET** after its latest sales report, but we think the trendy natural-foods retailer retains all the ingredients of a compelling growth story.

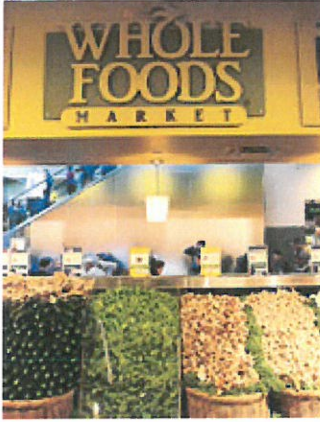
In early November, **Whole Foods** reported that fiscal fourth-quarter sales at stores open at least a year had risen 8.6%, the second straight quarter of less-than-double-digit gains. The news knocked the stock (ticker: WFMI) from 60 to 49, just above where it stood when *Barron's* ran a bullish piece on the company last summer ("**Fresh from the Farm**," Aug. 14). If management can meet more modest expectations, however, the shares could work back to 60 in 12 to 18 months.

"The story is not over at Whole Foods, as the company is just about to go through a material acceleration," says Canaccord/Adams analyst Scott Van Winkle.

The Austin, Texas, chain now expects same-store sales of 6% to 8% for the fiscal year ending September 2007. Chief Executive John Mackey calls 2007 a "transition year," as the company reverts to its historical mean after years of hyper growth. Same-store sales grew 11% in fiscal '06.

"We have raised the bar so high that we can't continue to jump over it at the same rate," Mackey told analysts and investors during the company's fourth-quarter conference call.

Still, Whole Foods will continue to jump higher than most. The acceleration of new-store openings -- 18 to 20 are expected this




With only 190 stores, market saturation is years away for Whole Foods. And the company is accelerating new-store openings.

fiscal year -- could boost same-store sales in coming years to 8% to 9%, analysts say. Management says that many new stores are profitable from day one.

Saturation seems years away for the chain, which has only 190 units. And, while management shaved fiscal '07 sales-growth expectations to a range of 13% to 17%, from a prior 15% to 20%, Mackey still expects to generate $12 billion in total sales in four years, compared with last year's $5.6 billion.

Weaker sales gains and heavy investment due to more store openings will crimp profit margins this year, resulting in an 8% increase in earnings per share. But JP Morgan analyst Stephen Chick pegs long-term growth at a muscular 15% to 20%.

"Square-footage growth that eventually accelerates north of the 16% targeted in fiscal '07 is likely," says Chick, who recently upgraded the stock to Overweight from Neutral.

Whole Foods sells for 35 times trailing earnings, and about 32 times this fiscal year's consensus estimate of $1.51. Its premium valuation leaves the company vulnerable to missteps, real or perceived. Cannibalization, and competition from chains like Trader Joe's and Wegmans, also are beginning to bite.

But management is optimistic. Last week, Whole Foods said it would add $100 million to its stock-buyback program. Long-time holder Jackson Robinson, head of the **Winslow Green Growth** Fund (WGGFX), also has been buying. In August, he told Barron's he expects Whole Foods to double in three to five years. Now, he sees a "reasonably valued" stock selling at 1.2 times sales, with a PEG, or price-to-earnings-growth ratio, of only 1.59.

-- *Christopher C. Williams*

## *Adidas' Upturn Still on Track*

**ADIDAS NEEDS TO HIT THE WEIGHT ROOM.** Turning around its Reebok International unit will require more heavy lifting than we predicted in last week's profile of the German sporting-goods company ("**Ready to Score**," Nov. 6.) Thursday, Adidas stock, which trades in Frankfurt, took its sharpest dive in years, after the company lowered its outlook for 2007 profit growth to 15% from a previous 20%. The main culprit: Adidas will need to invest an additional 50 million euros in North American footwear maker Reebok, which it bought in January.

While it is troubling that Adidas seems to have misjudged the problems at Reebok, the misstep doesn't squash the company's promising long-term growth prospects, which were highlighted in our story. Adidas officials noted that Reebok was profitable in the third quarter, and management still expects to realize 175 million euros in cost synergies by integrating its operations.

Investors kicked Adidas for cutting its outlook, but the pain is temporary.

"Reebok today is in much better shape than it was at the time of the acquisition," Adidas CEO Herbert Hainer said in the company's third-quarter earnings release.

The reduced outlook sent the stock down to €37 on the Frankfurt exchange, €2 below the price at which Barron's made its recommendation. Adidas (ticker: ADS.Frankfurt) had moved above €40 earlier in the week, following our bullish call, and we still believe it will rally as the added investment in Reebok bears fruit. Among other things, Adidas plans to beef up advertising and marketing for Reebok, and accelerate store openings for the brand in emerging markets, which could spur a turnaround by the second half of 2007.

Reebok's woes overshadowed an otherwise sterling quarter for Adidas, which grew profit and sales above analysts' estimates. Adidas is making some gains in the important North American market. Susquehanna Financial Group analyst John Shanley notes the Adidas division recorded a solid 6% increase in orders in the region in the quarter (before currency translations). That could lead to improving sales in the next several quarters, and buy Adidas management valuable time as Reebok catches its second wind.

"In the next two to three quarters, there may be more volatility," says Francis Claro of Evergreen Investment Management. "But it's premature to throw in the towel. The game has barely started."

*-- Christopher C. Williams*

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