SN SUPERMARKET NEWS

On analyst says the natural food chain "will have to be restructured unless comps turn positive."

NEWS > RETAIL & FINANCIAL

How bad can it get for Whole Foods?

This article is part of a series covering SN's annual Financial Analysts Roundtable, which on Sept. 19 brought together a prestigious group of industry experts to discuss the financial state of the food retailing industry. Click here to read the entire Roundtable transcript.

Liz Webber | Oct 21, 2016

When it comes to Whole Foods Market's legacy business, these days it seems to be all bad news.

Profit and comparable store sales have fallen as conventional retailers like Kroger and Costco have dramatically expanded natural and organic product offerings, obviating the need for shoppers to visit a specialty store like Whole Foods. In July, Whole Foods announced year-to-date net income fell 12.5% , while sales rose 2.3% and comps were down 2.4%.

On top of that, the retailer has failed to shake the “Whole Paycheck” perception, and has suffered from a series of image issues, including allegations of overcharging in New York stores .

Though the retailer’s new small format concept 365 by Whole Foods Market has so far impressed industry observers, it has also sparked fears of cannibalization , with prices at 365 stores coming in 15% to 20% lower than at legacy stores.

Industry analysts at *SN*’s 21st Annual Financial Analysts Roundtable last month said Whole Foods’ falling comps, more price competition, labor cuts in stores and an overly aggressive store growth plan could spell disaster if the retailer can’t turn things around.

“I mean they’re just not on a sustainable path. This company is going to have to be restructured unless comps turn positive, but there’s no catalyst for it,” said Scott Mushkin, senior retail/staples analyst, Wolfe Research.

“I think even assuming a modest level of gross margin investment — which is a realistic expectation over the foreseeable future — [with] negative comps [and] some SG&A deleverage — that kind of combination could be really catastrophic,” added Ajay Jain, senior analyst at Pivotal Research, New York.

Analysts agreed Whole Foods was making the problem worse by cutting in-store labor in order to reduce costs.

"I think management is really shocked at this slowdown in comps and they've got all these service departments and they cut out some man hours in the stores," said Chuck Ceranksoky, analyst with Northcoast Research, Cleveland. "It's a little bit like Walmart did a few years ago. Then your comps get even worse because it's not the experience the customer is used to. This is unusual ground for Whole Foods."

Yet, the analysts haven't written off Whole Foods completely.

"Whole Foods, however, has a great brand so we think it can be rescued, and we especially believe that the company's urban stores still do very well," said Mushkin.

In order to get out of its rut, Mushkin said Whole Foods needs to get basic items priced right, slow down store growth and perhaps close underperforming locations and renew its commitment to in-store labor.

"Then, 365 becomes icing on the cake if the economics work because I do think it's potentially a good format," Mushkin added.

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