# ALL EARS!!

*The Litchfield Fund Weekly Newsletter*

"We just don't hear it on the street, we have our ears spread across all the fields!!!!!"

Litchfield

**We continue our rock'n'roll inspired review** of falling stocks with the image in our heads of the skinny, loser-looking kid in his father's garage practicing electric guitar & writing songs about girls & ambitions clearly out of his reach. Of the many rock songs about losers, perhaps none is more poignant than Bob Seger's, shall we say beautiful, *Beautiful Loser!* It's the story of a nice, polite, decent guy, always ready to help a friend & shun the spotlight, who berates himself for wanting more! His rationale for the position he finds himself in is to never try to take it all, because of course, *it's easier and faster when you fall!*

*****Please note: The following review of stocks was written prior to this week's dramatic rocking & rolling stock market activity. We will allow the dust to settle before we comment on this week's market activity!*

**Eight Miles High & Falling Fast**: When it comes to picking stocks you want to aim high & pick winners. We know from Blood, Sweat & Tears (the band & our own efforts) *that what goes up must come down*, but we certainly don't want to take it as lightly as Mr. Seger's loser. We want to understand why certain stocks have not met expectations. We want to see if they have the opportunity to rise again. This week, we take a look at Whole Foods (**WFM**), Sprouts Farmers Market (**SFM**) & Vitamin Shoppe (**VSI**).

Whole Foods: For several quarters now **WFM** has fluctuated between good & bad news with the stock peaking over $57 in the last 12 months. The reality is that perhaps after 30 years **WFM** is no longer the only game in town! It no longer controls the market when it comes to new products, insights, innovation, etc. It has become big enough to have operational problems, shareholder lawsuits, & government actions. It is fighting giants like Walmart, Target, Kroger & Costco with pesky 'ankle-biters' like **SFM**, Natural Grocers (**NGVC**), Earth Fare, The Fresh Market, Fresh Thyme eating into the market. Its premium pricing model no longer provides consumers the value they expect. With that realization, WFM is creating a younger, hipper, trendier lower cost store aimed at millennials. Definitely risky, possibly self-cannibalizing, but certainly needed!

**WFM** is a long way from being an after-thought in the industry as a giant $15B retailer with some 400 stores. Everyone else is trying to catch up, and **WFM** boasts a strong debt free balance sheet to continue to fund expansion. While **WFM** has had the luxury of leading the market in terms of defining product quality, produce standards, animal treatment, etc., maybe the time has come to allow the industry to focus on those standards & policy and for **WFM** to focus on delivery. They need to get out of the spotlight of weight issues, product recalls, & shareholder lawsuits. They need to focus on same store comparable sales growth, operational excellence, & delivery consistency. We continually hear from new companies with outstanding products the difficulties of working with **WFM** nationally, regionally, & on a store-by-store basis. **WFM** needs to improve their ability to put new products on the shelves & to distribute nationally & consistently.

We have a high opinion of **WFM**'s leadership & fully believe they have the knowledge, experience, and balance sheet to raise the stock off 12-month lows & revitalize sales growth. However, growth may be more long-term as the focus shifts to the new *365 by WFM* chain!

**Sprouts**: Like **WFM**, **SFM**'s stock price rests at 12-month lows. They have one-half the stores of **WFM** & about 35% of the revenue. Their recent earnings reports reflect an increase in volume due to pricing efforts but a decrease in profit margin. **SFM** is consistent in its retail offerings, a nice mix of local/organic produce, & a strong commitment to local artisan products. Their store expansion seems timed & well-planned. With a 5-year projected annual growth rate of nearly 20% and a 1-year target price near $30 we believe a bounce is due over the next 12 months. However, **SFM** is undergoing leadership change & it remains to be seen if former CEO Doug Sanders continues to play a strong strategic role in **SFM**'s future. Unlike **WFM**, we see solid operational practices at **SFM.** Yet **SFM** has a lower sales/asset ratio than **WFM**, perhaps a reflection of pricing. Long-term we still like **SFM,** feeling they offer a nice counter balance to **WFM** while still being larger than other retailers in the sector.

**Vitamin Shoppe:** With **VSI**, the macro view may be more important than the micro view. That said, this past quarter was **VSI**'s first EPS estimate beat in more than a year. Its P/E is higher than the S&P average. Its PEG ratio is high due to a downgraded future revenue & earnings growth. Our opinion is that **VSI** was impacted more greatly than **GNC** by the overall opinion of the supplement industry. **GNC** may have been a bit more insulated because of its focus on muscle building & workout. **VSI**, sector-wise, is viewed more closely to vitamins & supplements. **VSI** has price targets reflecting 15% price gains & has rebounded from recent lows. We like **VSI**'s plans to shift to ready-to-eat on the go healthy foods & beverages! We think this is an under-served opportunity. While **GNC** plans the same, we see more **GNC**'s in malls & strip centers while **VSI** has better visibility & access in stand-alone or few store buildings on major roads & intersections. We feel this could provide a good future boost to revenue as we see a booming RTE/OTG food & beverage market.

**Earnings:** Zoe's Kitchen (**ZOES**) beat EPS & revenue estimates for 2$^{nd}$ QTR, outpacing same QTR last year revenue by 30%. Same store sales were up just 5.6%, not necessarily considered strong in the restaurant segment.

***Seeds***, ***Sprouts,*** Grow, Harvest!
**The Litchfield Fund**
V2issue11.08.29.15