



UNIVERSIDADE CATÓLICA PORTUGUESA

# Case Study: The Acquisition of Whole Foods Market, Inc. by Amazon.com, Inc.

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# Case Study: The Acquisition of Whole Foods Market, Inc. by Amazon.com, Inc.

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by

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# Resumo

Atualmente, é necessário que uma empresa se adapte rapidamente às mudanças do meio em que ela se insere. Neste sentido, fusões e aquisições podem funcionar como um instrumento chave para permitir que uma empresa atinja os seus objetivos estratégicos. Aplicando a metodologia de estudo de caso, iremos analisar a aquisição da Whole Foods Market pela Amazon (completada a 28 de Agosto de 2017). Com um valor total de aproximadamente \$13,57 mil milhões (\$42,00 por ação da Whole Foods Market), este negócio destaca-se como um dos maiores eventos de reestruturação empresarial desse ano, assim como a maior aquisição de um retalhista até à data. No presente estudo, pretendemos esclarecer os seguintes tópicos: (1) análise detalhada dos aspetos essenciais da aquisição; (2) quais os sinais que a aquisição nos transmite (tendo em consideração as mudanças nas preferências dos consumidores), e o que sinaliza em relação a futuros investimentos da Amazon. Resumidamente, concluímos que a aquisição da Whole Foods Market se adequa perfeitamente na estratégia da Amazon, permitindo-lhe não apenas expandir as suas capacidades, mas também alargar o seu ecossistema. Por último, também defendemos que esta aquisição pode ser apenas o primeiro passo de um processo longo e dispendioso para a Amazon que, em caso de sucesso, pode suscitar ganhos significativos para a empresa.

Palavras-chave: Fusões e Aquisições (M&A); Amazon; Whole Foods Market.



# Abstract

Today's environment requires that a company moves faster and responds quickly to its changes. In this sense, mergers and acquisitions can function as a powerful tool that allows a company to achieve its strategic goals. Here, applying a case study methodology, we will analyze Amazon.com's acquisition of Whole Foods Market (completed on August 28<sup>th</sup>, 2017). With an estimated total consideration of approximately \$13.57 billion (\$42.00 per Whole Foods Market's share), this deal positions itself as one of the biggest corporate restructuring events of that year, and as the largest acquisition of a brick-to-mortar retailer until the date. In this study, we hope to shed light on the following topics: (1) analyze the acquisition's key aspects; (2) what signals does the acquisition sends to the market (taking into consideration the changes in the consumers' preferences), and about Amazon's future moves. In short, we concluded that the acquisition of Whole Foods Market perfectly fits in Amazon's strategy, allowing it not only to empower its capabilities, but also to expand its ecosystem. On top of that, we also defend that this deal could be just the first step of a long and costly process to Amazon which, in case of success, can trigger substantial wealth-increases to the company.

Keywords: Mergers and Acquisitions (M&A); Amazon; Whole Foods Market.



# Index

Resumo.....	III
Abstract.....	V
Index.....	VII
List of Graphs.....	X
List of Tables.....	XII
1. Introduction.....	1
1.1. The Companies.....	1
1.2. Details about the Acquisition.....	3
1.3. Literature related to the Acquisition.....	6
1.4. Research Questions and Methodology.....	8
1.5. How the paper is organized.....	8
2. Literature Review.....	9
3. Data and Methodology.....	17
3.1. Data.....	17
3.2. Case Study Methodology.....	18
3.3. Limitations of Case Study Methodology.....	20
4. The Acquisition.....	22
4.1. M&A Activity Framework.....	22
4.2. Pre-Acquisition.....	24
4.2.1. Activism.....	24
4.2.2. Buyback.....	27
4.2.3. Target choice.....	29

4.3. Details about the Acquisition.....	33
4.3.1. Financing.....	36
4.3.2. Payment Method.....	38
4.3.3. Offer and Negotiation.....	40
4.3.4. Market Reaction to the Acquisition.....	49
4.3.5. Merger.....	55
4.3.6. Going-Private Decision.....	57
4.4. Post-Acquisition.....	59
5. Discussion.....	69
6. Conclusion.....	78
Bibliography.....	80
Appendix.....	107
Annex.....	114



# List of Graphs

**Graph 1:** Cumulative-Abnormal>Returns (T-10; T+10)

**Graph 2:** Cumulative-Abnormal>Returns (T-49; T+10)

**Graph A.1:** Whole Foods Market's historical stock prices, from April 2017 to the conclusion of the deal

**Graph A.2:** Amazon's historical stock prices, from April 2017 to the conclusion of the deal

**Graph B.1:** Amazon's M&A deals, from 2014 to 2018

**Graph B.2:** Amazon's number of M&A deals per industry, from 2014 to 2018

**Graph B.3:** Trends in M&A, from 1998 to 2017

**Graph B.4:** The S&P 500 Index and Net M&A announcements by quarter, from 2013 to 2017

**Graph B.5:** Prime Interest Rate and Net M&A announcements by quarter, from 2013 to 2017

**Graph B.6:** Net M&A announcements: monthly breakdown by value, in 2017

**Graph B.7:** Net M&A announcements purchase price distribution, from 2008 to 2017

**Graph B.8:** Payment trends in M&A, from 1998 to 2017

**Graph B.9:** Percent premium offered, from 2008 to 2017

**Graph B.10:** Deal value composition, in 2017

**Graph B.11:** Method of payment composition for deals above \$1 billion, in 2017

**Graph B.12:** Amazon's Prime Members among Whole Foods Market's customers



# List of Tables

**Table 1:** Whole Foods Market's Key Indicators – “Red-Flags” (quarterly)

**Table 2:** Whole Foods Market historical stock price and implied premiums

**Table 3:** Multiple valuation of Whole Foods Market

**Table 4:** Cumulative-Abnormal>Returns (CARs)

**Table 5:** Amazon's Post-Acquisition Key Indicators (quarterly)

**Table A.1:** Summary of the acquisition's key aspects

**Table A.2:** Multiples from Whole Foods Market's group of peers

**Table B.1:** Whole Foods Market's Income Statement (\$ Millions)

**Table B.2:** Amazon's Income Statement (\$ Millions)

**Table B.3:** Whole Foods Market's Total Assets (\$ Millions)

**Table B.4:** Whole Foods Market's Total Liabilities & Shareholders' Equity (\$ Millions)

**Table B.5:** Amazon's Total Assets (\$ Millions)

**Table B.6:** Amazon's Total Liabilities & Shareholders' Equity (\$ Millions)

**Table B.7:** Whole Foods Market's Cash from Op. Activities (\$ Millions)

**Table B.8:** Whole Foods Market's Cash from Investing Activities (\$ Millions)

**Table B.9:** Whole Foods Market's Cash from Financing Activities (\$ Millions)

**Table B.10:** Whole Foods Market's Cash Flows (\$ Millions)

**Table B.11:** Amazon's Cash from Op. Activities (\$ Millions)

**Table B.12:** Amazon’s Cash from Investing Activities (\$ Millions)

**Table B.13:** Amazon’s Cash from Financing Activities (\$ Millions)

**Table B.14:** Amazon’s Cash Flows (\$ Millions)

**Table B.15:** Whole Foods Market – Additional Information

**Table B.16:** Amazon – Additional Information

**Table B.17:** Whole Foods Market’s Key Indicators (annually)

**Table B.18:** Interests of Whole Foods Market’s Directors and Executive Officers in the merger (1)

**Table B.19:** Interests of Whole Foods Market’s Directors and Executive Officers in the merger (2)

**Table B.20:** Interests of Whole Foods Market’s Directors and Executive Officers in the merger (3)

**Table B.21:** Whole Foods Market’s projections

**Table B.22:** Whole Foods Market’s projections – complementary information (1)

**Table B.23:** Whole Foods Market’s projections – complementary information (2)

**Table B.24:** Voting Results from Whole Foods Market’s Special Meeting to approve the Merger Agreement

**Table B.25:** Aggregate number of securities to which the transaction applies, as in July 2<sup>nd</sup>, 2017

**Table B.26:** Amazon’s Post-Acquisition Key Indicators (annually)

**Table B.27:** Amazon’s Revenue by Segment (2018)



# 1. Introduction

## 1.1. The Companies

Amazon.com, Inc. (AMZN; NAICS<sup>1</sup> code: 518210) origins go back to Seattle, Washington, in the year of 1994. Under the name Cadabra Inc., a small company started its activity by selling books online. Today, it is considered the number one retailer in the world. At the beginning of 2018, the e-commerce giant is responsible for around 18% of the online grocery sales in the United States<sup>2</sup>. One of the principles that guide Amazon is customer obsession (rather than competitor focus), betting on the convenience and on offering the best prices. In fact, one of the factors that contributed to Amazon's success was the short time window between the ordering and delivery of its products – achieved through several warehouses strategically located across the United States. Further, the company is known for its focus on the long-term. Jeff Bezos, founder, chairman, president and CEO of Amazon, frequently highlights that his focus is primarily to invest in other platforms and products, having in mind the market share expansion, and long-term value creation.

Amazon's goal to be the “only” company that you need becomes every day more close to reality (even the arrow in the logo of the company, connecting the letter “A” to the letter “Z” sends the message that they are able to fulfill all our demands). Together with the expansion of its geographical reach, the company continues to diversify its “basket” of products/services. Shortly, these can be divided between: *Online Shopping* (currently Amazon's biggest source of revenue; Amazon continuously expands its online offerings through the acquisition of small online

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<sup>1</sup> North American Industry Classification System; a standard used by Federal statistical agencies to classify business establishments.

<sup>2</sup> According to One Click Retail.

businesses, ranging from clothes to medication)<sup>3</sup>; *Physical Stores* (apart from the Whole Foods Market’s stores, Amazon also possesses bookstores, pop-up stores, and some cashier-less convenience stores); *Web Services* (Amazon’s fastest growing segment, providing cloud services to several companies and government agencies); *Advertising* (currently the biggest percentage of “Other Revenues” of its financial statements); *Subscriptions* (in 2018, Amazon reached the mark of 100 million Prime Member subscribers worldwide, generating billions of dollars annually); *Hollywood Studio* (Amazon started producing its own content for Prime Video platform); *Amazon’s Private Label Bands Video Games, Audiobooks, Streaming Services*; and *Gadgets*. Among these, we highlight Amazon’s loyalty program (Amazon Prime membership). Despite the rise of its annuity, on May 2018, from \$99 to \$119, the number of subscribers continues to increase. Through it, Prime members can have access to unique products/services, as well as special discounts, such as unique deals on Amazon’s Prime Day<sup>4</sup>.

Whole Foods Market, Inc. (WFM; NAICS code: 445110) was originated from the consolidation between Safer Way Natural Foods and Clarksville Natural Grocery, in 1980. Based in Austin, Texas, WFM was the first supermarket chain to successfully sell natural and organic food on a large scale (also the first “Certified Organic” grocer in the U.S.)<sup>5</sup>. Its motto, “Whole Foods, Whole People, Whole Planet”, perfectly expresses how the company is managed. With its value-driven management style, it was able to attract and retain a considerable number of

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<sup>3</sup> More, Amazon offers programs that empower other small online businesses, enabling them to sell their products on its Websites and their own branded Websites.

<sup>4</sup> According to Amazon, Prime Member subscriptions tend to escalate, during this period. To our interest, the year after the acquisition, marked the first time WFM’s products and stores become part of the set of opportunities of Amazon’s Prime Day. For more details about Amazon’s Prime Day, please see <https://www.amazon.com/primeinsider/tips/get-ready-prime-day.html>

<sup>5</sup> At the time of the acquisition, WFM’s possessed physical stores across the U.S., U.K, and Canada. However, in this study, we will only focus our attention on the implications of the acquisition on its stores located in the U.S.

customers. More precisely, the idea of a farmer-friendly brand that offers healthier products for its consumers, allowed them to gain market share and establish themselves as one of the top grocery chains in the U.S. Other strand that always was a concern for WFM was the common welfare. Their foundation, Whole Planet Foundation, is just one example of their commitment in this regard<sup>6</sup>.

However, the recent past brought several problems for the company. The nickname “Whole Paycheck” (given by social media, due to the superior prices practiced by the company) was causing severe damages to the company’s brand<sup>7</sup>. On top of that, the company was not succeeding at giving a response to the increasing competition, which resulted into a loss of market share. In terms of performance, WFM was also struggling. Since 2015, its sales were almost flat and the “bottom line” of its financial statements was leaving its investors more concerned<sup>8</sup>.

## 1.2. Details about the Acquisition

Today, M&As are an important part of Amazon’s growth strategy, allowing it both to reinforce its position in industries in which the company was already operating and to expand its presence across new ones<sup>9</sup>, and to acquire complementary capabilities (filling the gap in its existing ones). To our interest<sup>10</sup>, the acquisition of WFM, in 2017, gave Amazon instant access to 2% of the \$600 billion-a-year American grocery market. On top of that, through the deal, Amazon would have its first experience, on a large scale, with “offline” retail. This key aspect would

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<sup>6</sup> For more detail, please see <https://www.wholeplanetfoundation.org/>

<sup>7</sup> Despite the company’s efforts to cut cost, and offer its products at a competitive price, the nickname continued to be present in the people’s minds.

<sup>8</sup> In order to complement the reader’s comprehension about our analysis, in *Annex – 1. Whole Foods Market’s and Amazon’s financial statements*, we provide both companies’ financial statements (standardized), as well as some additional information.

<sup>9</sup> See *Annex – 2. Amazon’s M&A deals*.

<sup>10</sup> See *Appendix – 1. Summary of the acquisition’s key aspects*.

give the online giant the possibility to enlarge its distribution channels and to better understand customers' in-store behavior.

During the months preceding the announcement of the acquisition, it is possible to identify some "red-flags" in WFM's financials. In a few words, we emphasize the fact that, in terms of profitability, the company was performing considerably worse than its peers. Moreover, a majority of WFM's key indicators (such as "Same-Store Sales") presented significant negative variation, when compared to the same period of the previous year<sup>11</sup>. These factors also might have served as basis for the activism conducted by Jana Partners LLC. On April 20<sup>th</sup>, 2017, the hedge-fund filed a Schedule 13D with the SEC disclosing that they had acquired approximately 8.3% of WFM's outstanding common stock, and that they intended to engage in active discussions with WFM<sup>12</sup>.

By analyzing the definitive proxy statement we learn that the first contacts received/initiated by WFM in order to engage in a corporate restructuring operation go back to two months prior to the public announcement of Amazon's offer. Contrary to public knowledge at the time of the announcement, throughout this time window, apart from negotiations with Amazon<sup>13</sup>, WFM also received separate inquiries, from four private equity firms and from two companies. The truth is that Amazon's proposal was superior to those from its competitor bidders. Its "deep pockets", allied with the complementarity in both capabilities and segments, positioned the company as the best alternative to reverse WFM's negative trend and to create more value<sup>14</sup>. As a result, the total consideration of Amazon's offer (\$42.00

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<sup>11</sup> These analysis is helpful to understand why WFM was an attractive target to Amazon.

<sup>12</sup> We consider this moment to be the beginning of the actions that lead to the acquisition of WFM by Amazon.

<sup>13</sup> On May 23<sup>rd</sup>, 2017, Amazon offered to pay \$41.00 per WFM's share. As a response, WFM asked for \$45.00 per share. Despite the rejection of this counterproposal, the online giant raised its offer to \$42.00 (non-negotiable), implying a premium of 17.61% (comparing to WFM's stock price as in the first contact with Amazon).

<sup>14</sup> Our case constitutes an example of mutual choice in M&A. John Mackey (WFM's CEO at the time of the deal) even stated that the possibility of a merger with Amazon was "love at first sight".

per share) was estimated to be approximately \$13.57 billion (including WFM's long-term debt and Amazon's total fee paid<sup>15</sup>, the acquisition's total purchase price sums approximately \$14.76 billion).

Amazon opted for paying the deal entirely with cash. In conformity, in order to finance the deal, the company decided to enter into a commitment letter with Goldman Sachs Bank USA, Goldman Sachs Lending Partners LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and Bank of America, N.A., to obtain a 364-day senior unsecured bridge term loan, summing a principal amount of \$13.7 billion, providing the desired speed and flexibility to complete the deal. Next, to fulfill its responsibilities towards the initial financing, Amazon choose to sell debt, totaling \$16 billion across seven tranches.

Changing the subject, from the market's reaction to the announcement of the deal, it is possible to conclude that investors perceived Amazon's acquisition as good news. In more detail, on June 16<sup>th</sup>, 2017, both WFM's and Amazon's stock prices rose 25.54% and 2.41%, respectively<sup>16</sup>. In other words, by analyzing both parties' stock prices it is possible to conclude that investors were anticipating significant synergetic gains from the acquisition<sup>17</sup>. Complementarily, in order to fully assess the market's reaction to the announcement of the deal, we also examined its impact on WFM's competitors' stock prices. In this sense, on June 16<sup>th</sup>, other

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<sup>15</sup> Relating to the deal, Amazon paid a total fee equal to \$25.704 million, while WFM paid a total fee equal to \$45 million (0.19% and 0.33%, respectively, comparing to the total consideration).

<sup>16</sup> Generating an abnormal-return of 25.62% and 2.79%, respectively. Further, considering the time window from 10 trading-days prior to the announcement of the acquisition to 10 trading-days after the announcement, the acquisition generated a cumulative-abnormal-return of 18.85% and 0.42% to WFM and Amazon, respectively.

<sup>17</sup> Following Bruner (2004), "true synergies create value for shareholders by harvesting benefits from merger that they would be unable to gain on their own".

retailers, such as Walmart, Target and Sprouts Farmers, experienced significant negative returns (-4.76%, -5.28%, and -6.50%, respectively)<sup>18</sup>.

With the end of incorporating WFM into Amazon's ecosystem, the organic-food chain merged with Walnut Merger Sub, Inc. (an indirect wholly owned subsidiary of Amazon which, apart from its formation and the activity related to the acquisition, did not had any other activities), in an operation denominated by reverse triangular merger. In more detail, the organic food chain merged with Walnut (the special-purpose-vehicle) and continued to exist. As a result of this operation, WFM became a subsidiary to Amazon<sup>19</sup>. The company continued to operate its stores under WFM's name/brand, and John Mackey maintained his functions. Conversely, individuals holding positions as directors of Merger Sub at the effective time would become the initial directors of the surviving corporation.

### 1.3. Literature related to the Acquisition

Other researchers have already analyzed the acquisition that we propose here to study. Nadar (2018), combines a qualitative and quantitative analysis in order to better understand the "abnormal" movement in the stock prices of the two companies. At the announcement, both companies' stock prices rose. According to the majority of the literature in this regard, it is not usual that acquirer's shareholders react in such a positive way to news concerning an acquisition (i.e. many times, acquirer's shareholders show some skepticism about initiating an acquisition, leading to a decline in the acquirer's share price). On the other hand, target's shareholders generally perceive an acquisition as good news for the company. The

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<sup>18</sup> The acquisition came at the same time as other important news to the food retail sector. The entrance of German retail giant Lidl in the U.S., and the alarms sent by the Kroger's profits turn the response by the markets very sensitive to adverse news.

<sup>19</sup> After the acquisition, WFM was delisted from NASDAQ and deregistered under the Exchange Act.

main conclusion of his paper was that, regardless the two companies' (combined) future performance, the deal would provide very useful data (not only for Amazon, but for the market too)<sup>20</sup>.

Additionally, an article of the Journal of Marketing Development and Competitiveness, explores the problems that affected WFM in the recent years, a company considered by them to have a distinct value-driven management<sup>21</sup>. These insights are helpful to our analysis, given that they point out which areas might be crucial for Amazon to intervene. WFM's core problems indicated by them were related to the loss of consumers' trust and loyalty. More, the PETA lawsuit imposed to the company in 2016, and the scandals related to mislabeling weights on their products were also contributing to WFM's brand deterioration. As a result, many started questioning if the "premium" paid for WFM's products was really worth it.

An alternative approach can be found on the work conducted by Philips-Connolly and Connolly (2017). The researchers analyze what implications the entrance of Amazon on this industry could have to "Big Food"<sup>22</sup> chains. They argue that the consumers' preferences are changing towards local, organic and less processed food, and that the traditional grocery store model is becoming obsolete. They conclude that the entire value chain of the food industry is going through some profound changes, and that the announcement of the deal made the alarms sound for "Big Food" firms. These companies have already started to react. Namely, some are adjusting their recipes, buying organic products from small producers, creating brands more "natural" and "healthy", among other actions.

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<sup>20</sup> Nadar (2018), also computes a valuation of WFM. Following his valuation, WFM were undervalued at the time of the deal - \$37.78 per share, implying a premium of 11.17%.

<sup>21</sup> See Cheretis and Mujtaba (2014).

<sup>22</sup> Term used to designate large industrial food producers and manufacturers.

## 1.4. Research Questions and Methodology

In this study, combining a qualitative and quantitative analysis, we propose to study Amazon's acquisition of WFM, from the time that preceded the announcement, to the integration process<sup>23</sup>. In this study, we hope to shed light on the following topics: (1) analyze the acquisition's key aspects; (2) what signals does the acquisition sends to the market (taking into consideration the changes in the consumers' preferences), and about Amazon's future moves.

Given the complexity of the questions, our approach was a case study methodology. As it is defended by Bruner (2004), this methodology is useful to study M&A deals. He argues that the adoption of a deterministic logic to understand M&A does not allow a fruitful description of a particular event. To answer our research questions, we gathered information from SEC filings concerning the acquisition, from several news/articles about the takeover (from the date of the public announcement, until the beginning of 2019), and from the two companies' financial statements.

## 1.5. How the paper is organized

The remainder of this study is structured as follows. In Section 2. we will present a literature review that allows us to better understand M&A activity and some practices associated with achieving success through it. In section 3. we will briefly describe the methodology and data used to answer our research questions. Section 4. is reserved for the analysis of the key aspects of the acquisition. In Section 5. we will present a critical analysis of the deal. Section 6. concludes.

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<sup>23</sup> Despite the complementarity between the legal, tax and accounting, and financial considerations, in this study, we will focus mainly on analyzing Amazon's acquisition from a financial perspective.

## 2. Literature Review

In the United States, the ownership and management of a company, by rule, is separated. In this context, shareholders vote for the board of directors, hoping that they will guarantee that managers will act according to their interests<sup>24</sup>. In the real world, the internal control devices that a company uses to impede its managers from taking non-value-maximizing operations might not be effective. On the same line of thought, many argue that agency problems cannot be avoided. In this context, the stock market performs an essential role in monitoring/disciplining managers' actions. Moreover, managers need to have discretion to react to unanticipated events. Bebchuk and Fried (2003) defend that the best option is to protect investors' rights and try to align interests through an efficient executive compensation plan<sup>25</sup>. The competition to determine who has the right to manage a company's resources plays an important role in limiting the divergences from shareholders' interests (i.e. the maximization of shareholder value). Jensen and Ruback (1983), perceive "competing management teams as primary activists entities, with stockholders (including institutions) playing a relatively passive, but fundamentally important, judicial role". More, the stockholders focus on the highest dollar value proposals, even if this means the removal of the incumbent management<sup>26</sup>. Many incumbent managers decide to implement a set of defense mechanisms as a response to the threat to their seats. These defenses can affect the company's value, and range from golden-parachutes, staggered boards, super-majority clauses, poison-pills, to a set of actions taken as a direct response to an offer, such as repurchases of voting-securities,

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<sup>24</sup> In the U.S., corporation law imposes managers a fiduciary duty towards the shareholders.

<sup>25</sup> Proxy fights – attempt to obtain enough proxies to obtain control – are another (yet more costly) way that can be used by a company's shareholder to remove incumbent managers.

<sup>26</sup> Lehn and Zhao (2006) provide evidence that "managers who make value-reducing acquisitions face a significant higher probability of being replaced (...) than managers who make value-enhancing acquisitions, either by internal governance, takeovers, or bankruptcy."

divestitures, issuances, and antitrust obstacles<sup>27</sup>. The authors also defend that managerial actions related to corporate control usually bring value to the stockholders. Similarly, Hanouna et al. (2001) concluded that the market values control – the direct power to cause more than 50% of the existing shareholder votes to be cast in the same manner – providing evidence that the median control premium paid for majority and comparable minority transactions is approximately 30% (in the U.S.).

In reality, the transference of control allows to “unlock” resources that might be inefficiently managed. Over the past century, there are several factors that contributed to the enhancement of the M&A activity in the United States, such as innovations in terms of financing, deregulation, weakening of some state antitakeover regulation, etc. Moreover, one important aspect that contributed for its development was the increasingly positive perception about these operations (i.e. the acknowledgement of its potential returns). Companies and investors are increasing their confidence in M&A. Nowadays, companies have really robust strategies to approach these operations, and their valuations and due diligence process go far behind the possible risks and financial perspective. By looking at the past decade, it is clear that acquirers are more selective about their targets. Also, companies are getting better at doing integration, which allows them to create more value to their stakeholders. McKinsey & Company stated on a report that “since 2010, more than 50% of all deals have left the acquiring and acquired companies worth more together than they were apart” and that acquirers “are at least no longer destroying value”.

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<sup>27</sup> Concerning its implementation, we can highlight two strands: the “managerial entrenchment hypothesis” – its implementation might result into an entrenchment of the current management or even deviate any offer that might be beneficial for the company –, and the “stockholder interests hypothesis” – its implementation can overthrow an inadequate offer either from the initial bidder or by leading to an auction. For more details about this topic, please see DeAngelo and Rice (1983); Comment and Schwert (1995); and Stout (2002).

Many companies integrate M&As as part of their growth strategy (particularly larger firms, according to McKinsey the vast majority of world largest companies use active M&A programs). However, the decision to engage into an acquisition can have multiple origins<sup>28</sup>. In order to explain their investment decision towards its shareholders, company's managers usually ground their decision with at least one motive for the acquisition. We divide some of the most commonly cited motives the following way<sup>29</sup>:

- *Strategic motives*: reduce competition, increase bargain power, defense mechanism (decrease the probability of being acquired, for example), entering into a new segment (or accelerate its process), complete the company's product line, acquire complementary skills;
- *Economic motives*: economies of scale, growth, increase stakeholders' wealth, misvaluation of another firm, complementarity in R&D, industry shocks, eliminate inefficiencies (getting better use for excess cash, for example), tax benefits;
- *Financial motives*: increase the company's debt capacity, reduce financing costs, reduce taxes, reduce earnings' variability.

To these list, we add one additional reason which is not publicly presented to the company's shareholders: *Managers' personal motives*<sup>30</sup>. Through the acquisition of another company, managers may try, for example: to achieve some specific goal that would allow them to receive an extra payment (e.g. increase sales), increase their prestige and value to the company (making his removal more costly to the

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<sup>28</sup> It is important to highlight that each case has its own particularities, implying a specific approach for each M&As in which a company engages.

<sup>29</sup> In this section we will only expose some of the motives. For more detail, please see Brouthers et al. (1998); Brealey et al. (2010), *Principles of Corporate Finance*, Chapter 31; DePamphilis (2015), *Mergers, Acquisitions, and other Restructuring Activities*, Part I.

<sup>30</sup> Frequently present in value-destroying acquisitions.

company), build an “empire”, or boost managerial ego. Other explanation is the “hubris hypothesis”, presented by Roll (1986): “Hubris on the part of individual decision makers in bidding firms can explain why bids are made even when a valuation above the current market price represents a positive valuation error”<sup>31</sup>. If this hypothesis holds, managers’ actions are recurrently not aligned with shareholder’s interests, due to their over-optimism<sup>32</sup>. Roll states that even if in the past one undertook value-destroying acquisitions, there is “little reason to expect that a particular individual bidder will refrain from bidding because he has learned from its own past errors”, because they still believe that their valuations are correct.

Nevertheless, many still relate M&A with a value-destroying (or at least not value-increasing) investment decision for the acquirer. In the literature is possible to find an extensive debate about the returns from M&As. Many authors, having in account several key aspects of an acquisition, present both evidences against and in favor of the value added from engaging into a takeover operation<sup>33</sup>. Our view goes in favor of the notion that an acquisition cannot be resumed to one (or few) quantitative indicator<sup>34</sup>. In fact, our approach to this acquisition perfectly mirrors this idea. When analyzing an acquisition, one should understand the fundamentals behind the numbers (i.e. one should understand what drives the value-creation, if

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<sup>31</sup> In the presence of value, the hubris hypothesis can also serve as an explanation for part of the premium paid in an acquisition.

<sup>32</sup> Bruner (2004), considers that the rationality (or irrationality) assumption about the markets and managers, influence M&A activity (*Applied Mergers & Acquisitions, University Edition*, p.83).

<sup>33</sup> Some authors even support the idea that, the lack of evidence to support that acquisitions are a value-increasing operation, comes from the fact that the acquirers are paying a fair price for the targets’ shares. For a more profound comprehension about this debate (as well as the gains distribution between the target and the bidder), and how investors’ perceive the value created through M&A, please see: Travlos (1987), Bradley and Sundaram (2006), Asquith (1983), Bradley (1988), Caves (1989), Fuller (2002), Healy (1992), Kaplan (1992), Loughran (1997), Maquieira (1998), Bruner (2003), Rau and Vermaelen (1997), Agrawal (1992), Megginson et al. (2004), Moeller et al. (2004), Cornett et al. (2011), Renneboog and Vansteenkiste (2018), Leaman et al. (2004), Jansen and Stuart (2013).

<sup>34</sup> Plus, the value-creation in M&A cannot be resumed to a single moment, such as the announcement (T=0). In M&A, one should consider several moment: T+30, T+180, T-30, etc.

the acquisition fits in the company's strategy, etc.). Brouthers et al. (1998) hypothesize that the negative performance associated to many acquisitions might come from the fact that this is measured by taking into account only one indicator. This indicator can fail to capture all the gains from the acquisition (i.e. undervalue the success of an acquisition)<sup>35</sup>. Another factor important to have into account when analyzing M&As is the difference between percentage gains and dollar gains. Usually, bidder and target differ considerably in size. In this situation, a dollar gain for the bidder may seem insignificant in percentage terms. Lastly, other rationale that explains the evidences of negatives returns in M&A is the one presented by Leaman et al. (2004). They claim that many studies obscure reality behind the "law of averages" (sizable losses in one deal may obscure gains of several small deals).

One related question that arises at this point is the identification of what draws the line between failure and success in M&A. In this respect, we defend that each M&A deal should be treated according to its specificities (i.e. each case is different). More, an acquisition comprises several "subactivities", such as the due diligence process, financing, negotiation, etc., and each one of these needs to be "tailor-made" to a specific deal. Consequently, the transference of a previous experience to a subsequent one (organizational learning) is expressly challenging in this context (Barkema and Schijven, 2008)<sup>36</sup>. However, any M&A should be analyzed ex-post. According to McKinsey (2013), "few found a way to build and continuously improve an M&A capability that consistently created value". Yet, even if the rationales of a previous acquisition do not apply to a subsequent one, an effective identification of the dissimilarities across deals can also serve as an important

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<sup>35</sup> Because the gains from an acquisition might be captured by stakeholders other than shareholders, or due to the difficulty to isolate the effects of an acquisition.

<sup>36</sup> The authors debated about transference of experience from one acquisition to another, deliberated learning mechanisms and the knowledge that may come from observing other firms' actions.

capability to a company that possesses an active M&A program, allowing it to effectively implement prior experience only when it is applicable. Having this in mind, a company should not expect to create a formula to achieve success in acquisitions. The difference between hit or miss in M&A depends on the way a company approaches it (i.e. depends on the discipline with which companies treat M&As).

The best hypothesis to achieve success in M&A is to follow a set of “rule of thumb”. The latter, ranges from the actively developing some capabilities, to avoid some common mistakes<sup>37</sup>. First, prior to make an offer, a company should conduct a due diligence process as complete as possible (in this phase, managers should be fact-based but knowledge-oriented). Bruner (2004) affirms that “its purpose in M&A is to support the valuation process, arm negotiators, test the accuracy of representations and warranties contained in the merger agreement, fulfill disclosure requirements to investors, and inform the planners of postmerger integration”<sup>38</sup>. The choice of the wrong target or the wrong time to acquire leads inevitably to failure.

When a company decides to acquire another, it must be sure that the latter fits into its strategy and that it perfectly identifies what drives (will drive) the value-creation<sup>39</sup>. Moreover, the expectations on synergies should be reassessed as the bidder learns more about the target. These are based on limited information (the one available at the time of the due diligence process), and after the completion of the deal, these estimates should serve as a basis, rather than the goal. At the same time, transparency plays a central role in the creation of value. Particularly, higher transparency during the negotiations, helps reducing the uncertainty about the

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<sup>37</sup> Here, we will approach those which we consider that extend to the majority of the companies. These “good” practices are not limited to the ones we will refer. For more details, see Bruner (2004), Chapter 38, for example.

<sup>38</sup> Bruner (2004), *Applied Mergers & Acquisitions, University Edition*, Chapter 8, p.228.

<sup>39</sup> It is important to highlight that both companies should focus on creating value, instead of claiming value.

potential gains that come from the acquisition, i.e. reduces the information gap and increase the probability of bidding efficiently. At the announcement, and during integration, bidders usually benefit from transparency concerning the synergies, risks (and its respective mitigations plans), and investments required to achieve them<sup>40</sup>. Those who disclosed detailed information, and subsequently update the market, are more likely to hold a positive effect on their share-price.

On the other hand, there are some behaviors that a company should avoid when engaging into an acquisition. One that stands out is overpayment. On its turn, overpayment might occur due to multiple reasons, such as: overestimation of the potential synergies (especially revenue synergies); overpayment for assets that “go down in the elevator” at the end of the day; failure in perceiving the time at which the synergies will emerge, and for how long they will prevail; overoptimistic evaluation of market potential; or overconfidence in the ability to integrate a firm. Nevertheless, in certain conditions, a given company can rationally overpay. For example, if the costs of losing a target to a competitor are superior to the ones from overpaying, a company can rationally overpay (minimizing its costs)<sup>41</sup>. Another scenario, yet a more difficult one to test, is the case in which a company could be in a worst situation if it had not acquired a given company, even if that acquisition turns out to be a value-destroying operation.

Equally important is the maintenance of the company’s focus on the strategy. Managers should not cede to pressures from the market, such as short-termism. Indeed, this may lead to a vicious circle: pressure to grow or to show results may lead to the settlement of unrealistic expectations (about the speed, ease, amount, and

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<sup>40</sup> Plus, it is important to clearly communicate the goals of a given takeover within the firm. On the other hand, companies need to be careful with the values which they present. If they are not rationally supported, or if they strongly deviate for reality, this signaling device may not be efficient.

<sup>41</sup> In contrast, if this rational does not hold, winning an auction can be more expensive than losing it – winner’s curse.

rewards of M&As), which consequently leads to the increase of the probability of failure, and ultimately to intensification of the pressure to show results. As a result, those who are held captive by investors' demands for quick payoffs, end up neglecting long-term growth.

## 3. Data and Methodology

### 3.1. Data

In order to evaluate Amazon's acquisition of WFM and to give an answer to the research questions which we propose to explore, we had to resort to multiple sources of information. As previously stated, an acquisition is an extreme complex operation, and resuming its evaluation only to quantitative data can lead us to wrong conclusions. Therefore, we gathered information from: the SEC filings concerning the acquisition; news and articles about the takeover (from the date of the public announcement, until the beginning of 2019); and from annual financial statements produced by both companies<sup>42</sup>.

By including non-quantitative data ("soft" information) in our analysis, we were able to provide a rationale for the numbers which we will present. On top of that, this kind of data is particularly valuable to understand what may drive value-creation on the long-term. In addition, to complement our understanding about the "subactivities" related to Amazon's acquisition, and enforce our critical sense, in subsequent sections we will also link the specificities of the deal with its related literature.

Concerning the quantitative approach of our study, we will also analyze: how the market reacted to the acquisition (weak-form test)<sup>43</sup>; compute the cumulative-abnormal-returns (semi-strong test); and evaluate the fairness of Amazon's offer by conducting a multiple valuation of WFM. Thus, we resorted to Thompson Reuters

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<sup>42</sup> To collect these information we resort to Thompson-Reuters Eikon database and the U.S. Securities and Exchange Commission's website.

<sup>43</sup> According to Bruner (2004), there are three ways of testing M&As' profitability: weak form (which consists in comparing the companies' stock prices before and after the deal); semi-strong form (which consists in comparing the companies' returns against a benchmark); and strong form (which consists in comparing the companies' situation with vs without the acquisition).

Eikon Database to collect data regarding: both companies' historical stock prices (as well as for the NASDAQ 100 Index, the benchmark to compute the cumulative-abnormal-returns); and a set of multiples to evaluate WFM's enterprise value and stock price on the closest moment, depending on the available data, preceding the announcement of the deal.

### 3.2. Case Study Methodology

One of the reasons that lead us to choose this particular takeover was the fact that this was not an "average case", i.e. apart from the fact that this acquisition represented the biggest one engaged by Amazon, and from its complexity, it might be worth to understand the fundamentals behind Amazon's decision what it signals to the market. Having all this in mind, it is reasonable to state that the case study methodology is the most suitable way to give an answer to the questions that we propose to discuss in this paper. More specifically, we propose to appraise the following topics: (1) analyze the acquisition's key aspects; (2) what signals does the acquisition sends to the market (taking into consideration the changes in the consumers' preferences), and about Amazon's future moves.

One major advantage of a case study research is its adequacy for discovering new patterns and behaviors, focusing on describe, rather than test (in a context of M&A, this type of studies can be crucial to identify possible drivers of returns). According to Yin (2003) "A case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context [...]. It copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result relies on multiple sources of evidence, with data needing to converge in a triangulating fashion [...]". Dul and Hak (2008),

add to this definition other important characteristic transversal to case studies, pointing that “a case study is an inquiry of only one single instance (the case), or sometimes a small number of instances, of the object of study”.

When compared to the majority of the studies about M&A activity, one key difference is the method of data analysis. Here, we will draw our conclusions using primarily a qualitative analysis of this case in particular. The contrast with the related literature around the M&A activity is evident, as the latter focus mainly on a large sample, i.e. they frequently use data from a population/several cases over a long period of time to draw their conclusions, trying to provide broad theories or hypothesis. It is also important to highlight that the use of whether qualitative or quantitative data are not exclusive to either of the methods exposed here. The use of different sources of information, from published news to the information extracted from the financial statements, perfectly reflect this point of view.

As it was argued by Bruner (2004), a deterministic sense is not suitable when one studies an M&A deal. These deals strongly depend on the human behavior, which is uncertain. As a consequence, the outcomes of an acquisitions will be largely influenced by this human factor. The idea that “If X is the condition, Y is the outcome” limits our analysis, or can even lead us to wrong conclusions. In other words, this methodology is the most appropriate way to give answers when the topic in question is complex and with a considerable degree of uncertainty<sup>44</sup>. Lastly, we recognize that the acceptance of a case study by its audience is strictly dependent on the validity claims contained in it, as well as “the status these claims obtain in dialogue with other validity claims”<sup>45</sup>.

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<sup>44</sup> Examples of case studies concerning M&A cases: Lys and Vincent (1995), ATT/NCR; Bruner (1999), Renault/Volvo; Bruner and Eades (1992), LBO of Revco D.; Hietala, Kaplan, and Robinson (2002), Takeover fight for Paramount; Ruback (1982), DuPont’s takeover of Conoco.

<sup>45</sup> See Flyvbjerg (2006).

### 3.3. Limitations of Case Study Methodology

One problem that is commonly referred when you conduct a case study is the fact that the results and conclusions cannot be generalized (Yin, 2003). In this specific case, the conclusions about the success/failure of the acquisition and posterior integration cannot be generalized, as some “magical formula” for M&As. We have to remember that the goal of this paper is to evaluate and understand the Amazon’s acquisition of WFM alone, and it is not expected that Amazon (or any other company) behaves the same way in all the takeovers they will engage.

The fact that the methodology chosen to this study is more oriented to generate hypothesis (strongly associated to the embryonic phase of the research process), in contrast to the mainstream studies in the literature, which are more focused into either testing hypothesis or theory building, is another argument against the case study research (Flyvbjerg, 2006). In more detail, case studies usually deviate from the classical formulation of new propositions and subsequent tests (i.e. the use of one or more statistical tests, opposing one hypothesis against its alternative). However, contrary to what was exposed above, some authors argue that this “division” is not rigid<sup>46</sup>.

Finally, the last “limitation” that we would like to highlight is the difficulty of testing the output – the knowledge – that is provided by this research (Flyvbjerg, 2006). Some troubles might, in fact, emerge if the researcher introduce some bias towards validation/verification of the study. Yet, this limitation could be also pointed to other methodologies. The problem many times attributed to case studies is the particularity that they give more “freedom” to subjectivity and arbitrary judgment. From the work developed by Campbell (1975), we can argue that a

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<sup>46</sup> See Eckstein (1975).

case study has its own value. Given that a case study enables us to “close in” on real-life situations, it is more likely to find a satisfactory explanation for a given event (contrasting with other methodologies, where it is common not to reach to a consensus or to present clear evidences that support a given hypothesis).

## 4. The Acquisition

### 4.1. M&A Activity Framework

To complement our understanding about the acquisition of WFM by Amazon, it is important to analyze the environment in which it occurred<sup>47</sup>. In fact, the "world" of M&A is clearly a product of the financial environment. An active takeover market is a strong indicator that the capital is flowing freely. In the literature, it is possible to find several theories trying to link the overall stock market performance to M&As. Jovanovic and Rousseau (2001), for example, postulated that higher merger activity is positively correlated with periods of higher stock market valuations. During these periods, investors usually are more optimistic about their investments. In this scenario, acquisitions initiated during bullish periods are expected to be favored (in the short-term) by the generalized upward trend of the financial markets<sup>48</sup>. Notwithstanding, during these periods companies' shares are more subjected to overvaluation. Some authors argue that many firms may use their own stocks as an "acquisition currency", exchanging overvalued stocks for real assets<sup>49</sup>. Rhodes-Kropf and Viswanathan (2004) suggest that increases on M&As may be solely due to valuation issues, where overvalued firms acquire undervalued (or less overvalued) firms. As per the work of Duchin and Schmidt (2013), "acquisitions initiated during periods of high merger activity are accompanied by poorer quality of analysts' forecasts, greater uncertainty, and weaker CEO turnover-performance sensitivity".

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<sup>47</sup> See *Annex – 3. M&A activity in the recent past*.

<sup>48</sup> Following Petmezas (2009), this optimism is frequently short-lived. Investors posteriorly revise their valuations in less prosperous times, and many companies fail to achieve some of the initial (biased) expectations. Alternatively, according to his work, low-valuation periods do not appear to influence the reactions towards an acquisition announcement.

<sup>49</sup> See Shleifer and Vishny (2003).

When we look over the years preceding the acquisition, we can identify several highs and lows concerning M&A activity. In comparison to the beginning of this decade, we can confirm that the operations are becoming even more sophisticated. As a rule, cash deals dominated recently, not only by number, but also by deal-value-added (McKinsey (2017)).

The recent levels of M&A activity (despite the recent slight decline) equaled the ones from the period between the end of the past century and the beginning of the past decade (plus, 2015 was marked by the establishment of a new high in terms of M&A activity, both in the U.S. and globally). This phenomenon occurred mainly due to: the return of Mega-Deals (i.e. deals over \$10bn.)<sup>50</sup>, considered by many the “motor” of M&A, the low interest rates, the accumulation of large stockpiles of cash by many firms, and the recent U.S. tax reform that allowed companies to benefit from lower tax rates. Simultaneously, we highlight the increase in M&A activity involving companies based in emerging markets. In the past few years, it is possible to observe not only an increase of deals in their internal markets, but also an increase in their cross-border deals. Overall, one of the most important factors that is driving M&A is the fast rate of technological change, which has been contributing to the disruption across sectors and fundament many cross-sector deals.

The year of 2016 was marked by small acquisitions. Despite the fact that levels of M&A activity were still above the long-term average, in 2016 we observed a decrease in the number of deals and in their total value (mainly due to a slight decrease in mega-deals). On the other hand, we witnessed higher prices (higher premiums) paid during this year, caused by the pressure to grow and the large cash stockpiles accumulated. In 2017, the number of deals, as well as its total value,

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<sup>50</sup> Despite its decline in 2016, after 2014 it is possible to observe an increase in the number of Mega-Deals completed, in comparison to the previous years (likewise these deals were also well received by the investors).

continue the negative trend from the previous year<sup>51</sup>, despite the positive market performance – considering the S&P 500 – during the same period. One possible explanation for this decline can be the increase of the prime interest-rate by almost 1 percentage point between the last quarter of 2016 and the last quarter of 2017. Lastly, in 2018 some factors, such as the Brexit, commercial conflicts involving the U.S., the signs of a possible end of U.S.’s bull market, and the slight increase in the stock market’s volatility, also contributed for a slowdown in M&A activity.

## 4.2. Pre-Acquisition

In M&A, when we look to what happens from the moment of the announcement of an offer, to the moment of the conclusion of the deal, we are only looking at the “tip of the iceberg”. Having this in mind, we start this section by analyzing some key aspects that preceded the public announcement of the deal<sup>52</sup>.

### 4.2.1. Activism

Today, it is common to see major companies being targeted by one (or more) activist investor<sup>53</sup>. Further, companies’ board seats are being increasingly occupied by them. In the U.S., along with this trend, more companies are putting themselves in the position of an activist investor, raising important questions about their performance and shareholder value creation<sup>54</sup>. In contrast, in the past, the general response to an activist action from the company’s management/board was most

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<sup>51</sup> Additionally, the average and median premium offered in 2017 reached the minimums levels of the past decade.

<sup>52</sup> For more detail about the several phases of the M&A process see DePamphilis (2015), *Mergers, Acquisitions, and other Restructuring Activities, Part II: M&A process*.

<sup>53</sup> By activist investors we mean “investment-management firms [...] that have acquired beneficial ownership of a company and filed a form 13D indicating intent to influence a management team.” (McKinsey, 2014). Form 13D is required when an investor detains, directly or indirectly, at least 5% of a firm.

<sup>54</sup> Between 2009 and 2015, approximately half of S&P500 firms had an activist investor as part of their shareholders (Gantchev et al., 2018).

likely a defensive one. Yet, they often overreact when an activist approaches them (similarly, if an activist receives a negative response, they might engage into a “fight” for which they are really prepared)<sup>55</sup>. The opponents of the intervention of an activist argue that his actions are motivated by myopic interests. More specifically, many support that these “myopic-activist” (especially hedge-funds) are only concerned about short-term gains, neglecting, or at the expense of, shareholder value in the long-term. In this respect, Bebchuk et al. (2015) examined a five-year window after an activist intervention. They provided evidence against these previous argument. The positive reaction (in terms of stock price) in the short-term, did not come at the expense of long-term performance. In fact, they even affirm that the initial reaction reflects the expected improvements in the long-term<sup>56</sup>. Concerning their influence on firms that actively acquire other firms, recent evidences show that these firms become more selective, engage into fewer acquisitions, and earn higher returns, not only at the announcement of an acquisition, but also on the long-term. Moreover, after analyzing the performance of dozens of activist campaigns, McKinsey concluded that the median activist campaign reverses the downward trend associated with the company targeted by them, and that the excess shareholder returns which they create tends to persist.

According to Larry Kanarek<sup>57</sup>, the best response would be a cooperative one. He defends that an activist often has “valid reasons for pressing companies”, and that a posture like this is more probable to bring benefits for both the company and its shareholders. This vision was being increasingly shared. Nevertheless, it might be useful to have an outside, more rational, perspective about the company. The

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<sup>55</sup> As an alternative, investors (such as hedge funds) can either acquire the company if their demands are not listened, or ultimately sell its shares. These two mechanisms also function as a disciplinary device for the targeted firm.

<sup>56</sup> See also Clifford (2008) and Klein and Zur (2009).

<sup>57</sup> McKinsey & Company director in 2014.

ultimate goal of an activist is the maximization of the returns for the shareholders. In more detail, they frequently intervene when a firm underperforms when compared to its industry peers, namely: when the shareholders' returns present a substantial lag comparing to its peers; a company is performing poorly in terms of revenue growth; a company is increasing its gap in margins, relative to its peers; or a company possesses large amounts of excess of cash and equivalents.

In the acquisition that we propose here to analyze, Jana Partners LLC showed perfectly how an activist investor is able to influence companies' decisions. On April 10<sup>th</sup>, 2017, Jana Partners filed a Schedule 13D with the SEC disclosing that they had acquired approximately 8.3% of WFM's outstanding common stock (becoming the second highest holder of WFM's shares), and that they intended to engage in active discussions with WFM's board of directors and management.

The takeover market has been a mean used by activists to create value for shareholders. Besides the discipline that they try to instill in who runs the company, an activist can also have an active role in attracting a potential acquirer for a given firm, as well as obtaining better terms on the deal. In this particular case, Jana Partners had a crucial role in inducing WFM to start looking for a new direction for the companies' future. On April 26<sup>th</sup>, 2017, Jana Partners' senior representatives met in person with John Mackey and other WFM's managers, in order to: present their perspectives on WFM; demand certain changes to WFM's board of directors; and explore the company's strategic alternatives.

Changing the subject, on average, the market perceives activists' interventions as positive news (creation of value to the shareholders), and tends to be efficient in differentiate between successful and unsuccessful campaigns. By

looking at WFM's stock prices<sup>58</sup>, it is perceivable a strong market's reaction to the news concerning Jana Partners' connection to WFM's. In detail, the organic grocery chain's stock prices presented a change of 9.51% on April 10<sup>th</sup> (comparing to the previous trading day)<sup>59</sup>. At the same time, the rumors concerning a potential acquisition of WFM's entire equity by Amazon or Albertsons Cos, Inc., started to emerge. These factors lead us to conclude that, prior the public announcement of Amazon's offer, WFM's stock price could already partially reflect (anticipate) the potential gains from a future corporate restructuring operation (either an actual acquisition or any other kind of restructuring operation). On the other hand, these reevaluations can also function as a deterrent for the acquisition itself, i.e. a substantial increase in the share price can put away an opportunity of bidding efficiently, and consequently create value.

#### 4.2.2. Buyback

Approximately one month before the announcement of the acquisition, WFM's board authorized a new share repurchase program, whereby the company could make up to \$1.25bn. in stock purchases of its outstanding shares (in open market transaction). Under this new program, WFM would not be obligated to acquire any particular amount of its common stock. Also, the timing, price, and size of purchases would depend on the prevailing stock prices and market conditions, among others factors.

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<sup>58</sup> In order to complement the comprehension of our analysis, we provide in *Appendix – 2. Companies' historical stock prices*, the evolution of both companies' stock prices from April 2017 (the month in which pre-acquisition process began) to the conclusion of the deal.

<sup>59</sup> On April 10<sup>th</sup>, WFM's stocks also generated an abnormal-return of approximately 9.53%. Additional information concerning the computation of (cumulative) abnormal-returns, and its results, will be provided further in this study.

Usually this kind of operation is associated with one of the following reasons: managers' perception that the company's shares are undervalued; managers' attempt to increase their vote ownership percentage (decreasing outside shareholders' influence); compensate a company's shareholders (as an alternative to the payment of dividends); and to protect the company against a possible takeover. According to WFM's board, this operation also allowed them to show their confidence in their long-term growth strategy, and that the company would return to positive comparable store sales and earnings growth in the near future. However, after analyzing the negotiating process (which will be discussed below), the most likely explanation for WFM's decision was to position itself as a more attractive target, and increase its control over the outcome of the ongoing negotiations.

Equally important is the analysis of the market reaction to this operation. In the literature it is possible to find evidences that stock repurchases are usually perceived as good news (increase in the stock price)<sup>60</sup>. However, we highlight that, simultaneously with this announcement, WFM also announced several board appointments and resignations, an update of WFM's business plan, and an increase of 29% (to \$0.18) in its quarterly cash dividend. The truth is that the market barely reacted to these news. At this point, we remember that in the previous month, the company's stocks had already been revaluated. Therefore, one possible explanation for the weak reaction from the market was the fact that these kind of changes in the firm were anticipated one month before, i.e. at the moment in which Jana Partners informed that it would actively influence WFM' decisions.

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<sup>60</sup> Golbe and Nyman (2013), provide evidences that the larger the repurchase, the larger the increase in stock prices tends to be.

### 4.2.3. Target choice

At first glance, one may be skeptical about Amazon's decision to acquire WFM. According to literature, the distance between the two companies, i.e. the fact that the two companies operate in unrelated industries<sup>61</sup>, increases the challenge of integration. In general, when two unrelated companies merge the integration process is likely to be more extensive, due to the weak (if any) overlap of knowledge and skills. Nevertheless, it is possible to identify several complementary resources and capabilities between the two companies. In our opinion, the acquisition of WFM is strictly aligned with Amazon's strategy, and can be grounded in the following three rationales<sup>62</sup>:

- *Fast entrance in the organic food industry*: in the recent past, organic food industry presented itself as a fast-growing industry in the U.S. Despite the fact that, through Amazon Fresh<sup>63</sup>, Amazon has already had its first contact with food distribution, its presence was insignificant when compared to other grocery chains (WFM would give Amazon the possibility of diversifying its offerings)<sup>64</sup>. At this point, Amazon had two options: grow organically, or acquire an already established company in the industry. Considering the WFM situation, the latter would probably take less time and resources to Amazon, given that it would give instant access to more than 460 physical stores and a more ample spectrum of products. Another important aspect to highlight is the particularities of food warehouses. They require a certification from the U.S. Food and Drug Administration, extra care in terms of hygiene,

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<sup>61</sup> As it is indicated by their NAICS codes.

<sup>62</sup> The reasons presented by WFM's board of directors can be found in the definitive proxy statement, filled by WFM on July 21<sup>st</sup>, 2017.

<sup>63</sup> A subsidiary of Amazon.com.

<sup>64</sup> In fact, accordingly to Ooghe et al. (2003), multiple acquirers tend to acquire complementary firms in terms of sales and growth opportunities.

different cooling systems, among other requirements that WFM's stores could already guarantee to Amazon. Additionally, some surveys indicated a considerable overlap between the two companies' customers – especially millennials<sup>65</sup>. This similarity would then enable Amazon to “lock” a big part of the existing WFM's customer base, as well as facilitate the attraction of new customers<sup>66</sup>.

- *Expand Amazon's distribution channels*: the acquisition of WFM also allowed Amazon to fill a gap in its distribution channels. Prior to the acquisition, Amazon had already demonstrated its desire to control its delivery chain<sup>67</sup>. Through the acquisition of more than 460 physical stores, the online giant considerably increased its capabilities to fulfill one of its value propositions – its fast-delivering services. In particular, WFM's stores could function as “small” warehouses for Amazon's customers' orders. Plus, with the acquisition Amazon would manage to be near the population centers<sup>68</sup>. One example of Amazon's commitment towards dominating this “last-mile” of distribution was the introduction of Amazon Lockers into WFM's stores. These lockers gave Amazon's customers the option to collect (and return) their online orders into a WFM store.

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<sup>65</sup> More, a considerable (increasing) part of WFM's customers were already Prime members. See *Annex – 4. Amazon's Prime Members among Whole Foods Market's customers*.

<sup>66</sup> A vast majority of Amazon's Prime members are not regular shoppers at Whole Foods. On the other hand, organic-food consumers are among the highest spenders. One of Amazon's challenges/opportunities would be to develop new capabilities to, like it has developed on its online services, retain this customers and lead them to consume more.

<sup>67</sup> More precisely, in order to lower its shipping costs and strengthen its operational independence, Amazon had plans to start leasing its own delivering trucks, planes and drones.

<sup>68</sup> According to a Morgan Stanley report, within 2 years “33 million US households live within 5 miles of a Whole Foods store”. More details in <https://qz.com/1077662/amazon-prime-could-double-whole-foods-shoppers-over-the-next-five-years-morgan-stanley/>

- *Learning about customers' "offline" behavior*: another way to look at the deal is as an "acquisition of data"<sup>69</sup>. One of Amazon's strongest features is its ability to predict what its online customers want to buy. By contrast, the company possesses practically no knowledge/experience about the "offline" behavior of the customers. In this sense, the acquisition could serve as a "test" for Amazon's future moves into "offline" businesses (capability-building). Together with the learning opportunities that WFM could offer (concerning in-store selling strategies, for example), Amazon was now able to analyze the data from each purchase at WFM stores<sup>70</sup>.

Without a doubt, Amazon's technologies, expertise, deep pockets and reputation were important factors that lead WFM's management, and its shareholders, to give the "green light" to the merger and not to seek for any other bid<sup>71</sup>. On top of that, WFM's financials had been deteriorating in the years preceding the acquisition<sup>72</sup>. For this reason, in the table below we present a closer look on a set of WFM's key metrics during the three quarters preceding the acquisition:

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<sup>69</sup> Nowadays, many consider data the "new gold".

<sup>70</sup> Especially, if the payment was made using Amazon Reward Visa Card.

<sup>71</sup> As it will be discussed in subsequent sections, this acquisition represents a case of mutual choice between WFM and Amazon.

<sup>72</sup> See *Annex – 5. Whole Foods Market's Key Indicators*.

	Industry Median	Jan-2017	Apr-2017	Jul-2017
Same Store Sales <i>4Q Growth</i>	-	(2.4%) (0.6%)	(2.8%) 0.2%	(1.9%) 0.7%
Gross Profit Margin <i>4Q Growth</i>	77.0%	33.6% (0.4%)	34.1% (0.8%)	34.0% (0.7%)
EBITDA Margin <i>4Q Growth</i>	43.3%	8.2% (0.1%)	8.6% (1.0%)	7.9% (1.0%)
Operating Margin <i>4Q Growth</i>	39.1%	3.5% (1.7%)	4.6% (1.9%)	4.8% (0.8%)
Pretax Margin <i>4Q Growth</i>	36.8%	3.2% (2.0%)	4.3% (2.1%)	4.6% (0.7%)
Effective Tax Rate <i>4Q Growth</i>	20.6%	39.1% 2.2%	38.9% (0.7%)	38.7% (0.1%)
Net Margin <i>4Q Growth</i>	29.1%	1.9% (1.4%)	2.6% (1.2%)	2.8% (0.4%)
Asset Turnover <i>4Q Growth</i>	-	0.77 (4.1%)	0.58 (1.2%)	0.57 (3.1%)
Pretax ROA <i>4Q Growth</i>	-	2.5% (1.7%)	2.5% (1.2%)	2.6% (0.5%)
Pretax ROE <i>4Q Growth</i>	3.3%	4.8% (2.3%)	4.9% (2.3%)	5.1% (1.0%)
x Tax Complement <i>4Q Growth</i>	0.80	0.61 (3.4%)	0.61 1.1%	0.61 0.1%
ROE <i>4Q Growth</i>	2.7%	2.9% (1.6%)	3.0% (1.3%)	3.1% (0.6%)
x Earnings Retention <i>4Q Growth</i>	0.67	0.53 (26.9%)	0.56 (19.5%)	0.44 (30.9%)
Reinvestment Rate <i>4Q Growth</i>	1.8%	1.5% (1.7%)	1.7% (1.3%)	1.4% (1.0%)
ROIC <i>4Q Growth</i>	-	1.9% (1.4%)	1.9% (0.9%)	2.0% (0.4%)
Assets/Equity <i>4Q Growth</i>	8.71	1.94 1.4%	1.94 0.1%	1.91 (3.0%)
Debt/Equity <i>4Q Growth</i>	0.14	0.32 (1.3%)	0.31 (2.5%)	0.30 (8.2%)
% LT Debt to Total Capital <i>4Q Growth</i>	1.7%	24.1% (0.3%)	23.8% (0.4%)	23.2% (1.6%)
(Total Debt- Cash)/EBITDA <i>4Q Growth</i>	(1.32)	0.81 -	0.76 (20.3%)	0.36 (63.0%)

**Table 1:** Whole Foods Market's Key Indicators – “Red-Flags” (quarterly).

Source: Thompson Reuters Eikon Database.

By analyzing the table above it is possible to identify several “red-flags” in WFM’s financial situation prior to the acquisition. These indicators could serve as a basis to understand why WFM was an attractive target to Amazon, not only due to the possibility that it might be trading below its potential value<sup>73</sup> (in this case it would be cheaper to acquire WFM than grow organically), but also to perceive why WFM was intending to initiate a restructuring operation.

In brief, we highlight that in terms of profitability (measured by its *Gross Profit Margin* or its *Net Margin*, for example) WFM was performing considerably worse than its peers<sup>74</sup>. The deterioration of the company’s “*Same-Store Sales*” also perfectly reflects one of the major problems that the company was facing prior to the acquisition. Lastly, by analyzing the evolution of this indicators (in comparison to the same period of the previous year), it is perceptible the deterioration of WFM’s financial situation.

### 4.3. Details about the Acquisition

Regarding the offer that was made, the majority of the analysts considered that it was based on a fair valuation of WFM and its potential synergies. Also, it was almost unanimous that the acceptance of the offer would be very beneficial for the current WFM’ management<sup>75</sup> and for its investors. Indeed, the board of directors of each party unanimously approved and recommended the acceptance of the deal

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<sup>73</sup> When a company’s shares are being traded below its potential value, either due to mispricing or mismanagement, there is an incentive for outside parties to acquire the company (trigger effect).

<sup>74</sup> Yet, WFM’s return on equity was slightly higher than its peers (probably due to its higher *Asset Turnover*, given that the company presents lower margins and lower leverage).

<sup>75</sup> Frequently, bidders are criticized for focusing on offering excessive private benefits to the target’s managers/directors to the detriment of the price (agency problems). For more details, see *Annex – 6. Interests of Whole Foods Market’s Directors and Executive Officers in the merger*. Plus, following the “Agreement and Plan of Merger”, Amazon agreed to indemnify and hold harmless WFM’s officers and directors.

(while the deal required the approval by the holders of a majority of WFM's outstanding shares; its approval does not require the vote of Amazon's shareholders)<sup>76</sup>. John Mackey even stated that the possibility of a merger with Amazon was "love at first sight", and reinforced the idea that Amazon would bust their loyalty programs and help them with their efforts to lower prices.

Similarly, shortly after the announcement, some potential synergies have been pointed out. Many expected that Amazon, due to its past history of abdicating profits to gain market share, was able to reverse WFM's trend. Along with this, it was expected that Amazon would be capable of: improving its operating discipline, significantly enhance its online offer, implement several technological innovations in-store, and increase WFM's customer base. Alternatively, the acquisition can also be perceived as one way to magnify the potential benefits to the present, and future, Amazon's Prime members.

On the other hand, some analysts highlighted the risks that Amazon would face. To those challenges coming from WFM's performance, adds the increase of competition in the organic food industry<sup>77</sup>. Simultaneously, Amazon had to be careful to not deteriorate the idea of a farmer-friendly brand, independent and authentic, which enabled WFM to conquer a considerable number of loyal clients<sup>78</sup>. To these set of risks we also add the uncertainty about the potential growth of "online grocery shopping" (i.e. uncertainty about which part of consumers will

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<sup>76</sup> WFM's financial advisor for this deal, Evercore Group LLC, also considered Amazon's offer as fair, from a financial point of view. For more details about Evercore's opinion, see "Annex B", together with section "Opinion of Whole Foods Market's Financial Advisor", from the Definitive Proxy Statement, filled by WFM on July 21<sup>st</sup>, 2017. WFM's shareholders who voted against the deal, and who objected in writing to it (and comply with all of the applicable requirements of Texas Law), were entitled to dissenters' rights of appraisal to obtain the fair value of their common stock, instead of the per share merger consideration (see Annex C from the Definitive Proxy Statement, filled by WFM on July 21<sup>st</sup>, 2017).

<sup>77</sup> This factor, together with the entrance of Amazon, could lead to thinner margins in this industry.

<sup>78</sup> It was speculated that Amazon would continue to rely on United Natural Foods Inc. to supply WFM.

change their preferences towards ordering groceries online, and how fast their preferences will change).

Some retailers, which had already expressed their concerns about the taxation of online companies, feared that the entrance of Amazon would raise problems about the price competition<sup>79</sup>. These alarms turned attentions towards the Federal Trade Commission, which main goal is to prevent any attempt of anticompetitive practice, promoting the protection of the consumers (the deal also required the approval by the Antitrust Division of the United States Department of Justice and the Canadian Commissioner of Competition)<sup>80</sup>. The possibility of an opposition to the deal by this antitrust entity also symbolized a potential substantial cost for the stockholders of both firms. However, after considering what implications the acquisition might have in terms of lowering the competition, or setting an unfair one among the food industry, the acquisition was approved.

Another topic explored in the media was the implications that the acquisition could bring for the current WFM' employees. In addition to the decrease of their bargain power, some feared that Amazon would convert WFM's store into click-and-collect centers (automatization of WFM's store)<sup>81</sup>. Amazon Go stores, for example, were already operating under this molds. Through Amazon Go app, costumers could register what they are buying, being automatically billed on their online Amazon account, without any human contact.

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<sup>79</sup> Amazon is currently paying taxes in every state of the U.S. in which it has physical stores.

<sup>80</sup> The Clayton Act of 1914 forbids an acquisition whenever "in any line of commerce or in any section of the country" the effect "may be substantial to lessen competition, or to tend to create a monopoly."

<sup>81</sup> Despite the probability of massive layoffs to be reduced in friendly acquisitions, many feared this outcome. However, one may argue that their jobs were already at stake due WFM's past performance.

### 4.3.1. Financing

In a market-based financial system, like the one from the U.S., it is very common to see a company resort to the bond and/or the stock markets to satisfy its needs<sup>82</sup>. In order to finance the purchase of WFM, Amazon entered into a commitment letter with Goldman Sachs Bank USA, Goldman Sachs Lending Partners LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and Bank of America, N.A., in order to obtain a 364-day senior unsecured bridge term loan, summing a principal amount of \$13.7 bn. (providing the desired speed and flexibility to complete the deal)<sup>83</sup>. The availability of this bridge loan was subject to reduction in equivalent amounts upon the issuance by Amazon, or its subsidiaries, of debt securities, equity interests, or consummation of certain asset sales prior to the conclusion of the deal (also, this funding was contingent on the completion of the deal)<sup>84</sup>. Next, to fulfill its responsibilities towards the initial financing, Amazon choose to sell debt, totaling \$16 bn. across seven tranches: 40 basis points (bps) over T-Bonds for the U.S. \$1bn., 3 years; 60 bps over T-Bonds for the \$1bn., 5.5 years; 75 bps over T-Bonds for the \$2bn., 7 years; 90 bps over T-Bonds for the \$3.5bn., 10 years; 105 bps over T-Bonds for the \$2.75bn., 20 years; 125 bps over T-Bonds for the \$3.5bn., 30 years; and 145 bps over T-Bonds for the \$2.25bn., 40 years<sup>85</sup>. Given the infrequency of opportunities to acquire Amazon's high quality debt, it was with no surprise that the e-commerce giant succeeded in this operation (market for debt).

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<sup>82</sup> Plus, the U.S. offer high levels of protection to its investors, enhancing their willingness to finance firms.

<sup>83</sup> By contrast, bridge loans are typically stricter in terms of loan covenants, and have higher interest rates when compared to other debt securities. For more details about the financing of the deal, see Exhibit 10.1 from the Form 8-K filled by Amazon on June 15<sup>th</sup>, 2017.

<sup>84</sup> The completion of the deal was not dependent on the way of financing chosen by Amazon.

<sup>85</sup> At the time, the credit ratings of Amazon, according to Standard & Poors and Moody's were AA- and Baa1, respectively. Karampatsas et al. (2014), provided evidences that bidders holding higher credit ratings are more likely to use cash financing in M&A (given their lower financing constrains and easy access to debt markets).

From the bank's standpoint, bridge loans possibly assure more than one source of income. Together with the initial source of income, banks can also profit from the subsequent fees from the private placement/underwriting of the company's securities. It is also important to highlight the certification and monitoring role of banks. As it was previously referred, an acquisition is an extremely complex process. To this factor adds the potential for asymmetric information between parts, which difficult the task of estimating the potential value of an acquisition. If the logic that the banks are only available to finance "good projects" holds, the financing of Amazon's acquisition through the bridge-financing sends a credible sign about the quality of the deal. More, the financial advisor's expertise and experience could play an important role in monitoring post-acquisition actions, screening target candidates, valuating the target and the potential synergies, structuring the deal, etc.<sup>86</sup>.

In the meantime, one may ask what other means of financing Amazon had to complete the acquisition. In this respect, it is possible to find in the literature some rationales that support Amazon's decision. Alternatively, the online giant could have used internal financing – use of excess cash – or opted for issuing equity<sup>87</sup>. Concerning the first alternative, one may argue that Amazon intended to preserve its excess cash for future investments. Following Pinkowitz et al. (2013), the "link between cash stockpiles and cash acquisitions is not obvious", and cash rich firms are less likely to make cash offers (counter to the conventional wisdom). More,

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<sup>86</sup> These external advisors, as well as law firms, can earn significant fees for their services. Hunter and Jagtiani (2003), provided evidences that larger fees are associated with larger post-merger gains. They also state that the payment of larger fees is associated with a shorter time period for the completion of a deal, but not with the probability of its completing. More, Bao and Edmans (2011) provide evidence that skilled investment banks add value, due to their ability in identifying synergistic targets and negotiating more favorable terms (skilled-advice hypothesis).

<sup>87</sup> A company's decision about its financing also weighs against several factors, such as capital structure. For a more profound analysis, see Graham-Harvey (2001), Myers (2001), and Frank-Goyal (2009).

despite the fact that Amazon had enough excess cash to acquire WFM without resorting to any financing, we do not have information about its portion of USD.

Changing the subject, the choice of financing through debt, rather than the issuance of equity, can also be rationally grounded. According to Myers (1984), in the presence of asymmetric information about the company's/project's true value, and if managers act according to the interests of the old shareholders, they will refuse to issue equity to finance the deal. Indeed, investors tend to react negatively to stock issuances (signaling hypothesis)<sup>88</sup>. Many managers decide to issue stocks when they perceive that its company is overvalued. Additionally, the awareness of this information asymmetry (even if it does not exist) also affects the price at which the stocks would be priced. New issues often incorporate a discount. This comes from the attempt to diminish the rationing and to ensure that uninformed investors purchase its shares (i.e. the equilibrium offer price contains a discount to invite less informed investors to buy a company's shares). To conclude this section, we highlight that Amazon possessed large debt capacity at the time of the deal. Plus, despite the negative effects that debt can have on reported earnings, it is less sensitive to information asymmetries than equity, and functions as a disciplinary device for managers (given the priority of its repayments, its covenants, etc.)<sup>89</sup>.

#### 4.3.2. Payment method

In line with the previous section, to acquire WFM, Amazon paid entirely with cash<sup>90</sup>. Following the literature, the choice of the payment method is

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<sup>88</sup> In contrast, Bharadwaj and Shivdasani (2003) provide evidences that "Acquisitions that are entirely financed by banks are associated with large and significantly positive acquirer announcement returns".

<sup>89</sup> Long-term debt can also be a powerful tool to deter investors' short-termism.

<sup>90</sup> In the past two decades, cash deals tended to dominate among the alternative payment methods (such as exchange of stocks, combination of cash and stock, subordinated debt, convertible securities, etc.).

unquestionably one feature that influences the completion of an acquisition. Additionally, this decision can also have a direct impact on investors' reactions at the announcement of the deal, and on how the gains/losses will be distributed between the bidder and the target. In this regard, each alternative payment method has its pros and cons. One should always weigh them against the specificities of the deal<sup>91</sup>.

Acquisitions payed entirely with cash usually shows the bidder's confidence in the deal. In other words, cash deals are more frequent when the bidder is confident about its capabilities to obtain synergetic gains from the deal. Another possible rational for Amazon's choice is the hypothesis of undervaluation of its shares. If its prospects about its future value implied a superior price (compared to the market price), exchanging shares would not be beneficial. In brief, some key aspects of this payment method are the following:

- *Fixed payment*: in contrast with other payment methods, cash deals do not depend on future performance. Together with their simplicity, these deals give the bidder the opportunity to claim the entire value created with the acquisition (on the other hand, if the deal leads to value-destruction, the bidder has to support all the losses). This factor could also result in less incentives for the target, in terms of future performance<sup>92</sup>.
- *Better market's reaction*: several evidences show that cash deals lead to greater returns at the announcement (evidences that link cash deals with post-takeover performance). Also, cash deals are more easy to evaluate (less exposure to market's misvaluations)<sup>93</sup>.

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<sup>91</sup> For more detail about the determinants of this decision, see Ismail and Krause (2010).

<sup>92</sup> Yet, there are other ways to guarantee the alignment of interests between the bidder and the target, e.g. earnouts, escrow accounts, stock options, etc.

<sup>93</sup> See Rhodes-Kropf and Viswanathan (2004), Di Giuli (2013).

- *Less exposure to price pressures*: when compared with stock-for-stock deals (especially in fixed-exchange-ratio stock deals), cash deals are much less exposed to arbitrage short-selling. At the announcement, arbitrageurs usually implement a strategy that consists on selling acquirer's shares, and buying target's shares to cover their position (based on the announced exchange ratio to remain hedged), which causes a downward pressure<sup>94</sup>.
- *Greater exposure to information asymmetry costs*: in case of information asymmetries about the target's true value, the acquirer supports all the costs.
- *Taxability*: contrary to other payment methods, in which part of the payment is deferred in time, cash deals accelerate capital gains taxation. Considering this factor, one may argue that cash offers usually embed a premium to maintain its attractiveness for target's shareholders.

### 4.3.3. Offer and Negotiation

The financial markets usually penalize when the negotiation period is extensive. Having this in mind, when two companies begin a negotiation, it is in the interest of both parties that the possibility of deadlock be reduced and that the total gains that both parties can achieve be maximized.

One aspect that clearly stands out concerning the acquisition of WFM by Amazon is the relatively short time window between the announcement of the deals and its conclusion. Yet, and in accordance to what it was previously referred, this time period may be just be the "tip of the iceberg". Prior to the public announcement of an offer, the target and the bidder(s) may already have discussed many details

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<sup>94</sup> According to Mitchell et al. (2004) and Liu and Wu (2014), part of the negative (or at least less positive) returns around M&As is due to arbitrage strategies. The authors found evidences that this pressure tends to disappear in cash deals.

about the future operation<sup>95</sup>. Following Boone and Mulherin (2009), the “decision by sellers to impose constraints on the number and kinds of bidders and otherwise ‘manage’ the selling process to reduce information costs can actually create value”. The “traditional tool” to measure competition in corporate takeovers – i.e. the number of bidders that publicly attempted to acquire the company – may fail to capture the whole story. At the same time, one should pay extra attention when classifying a given deal in terms of its nature, i.e. a deal that appears to be friendly, may have started as a hostile one, and vice-versa. In this regard, Boone and Mulherin (2007), consider that the most proper way to capture this phenomenon is by analyzing the data contained in the SEC documents related to the merger.

By analyzing the definitive proxy statement concerning the acquisition, the short time window comes with no surprise. The first contacts received and/or initiated by WFM in order to engage in a corporate restructuring operation go back to two months prior to Amazon’s offer. Following the rumors about Amazon’s interest in acquiring WFM, John Mackey, Ken Meyer (a WFM’s Executive Vice President of Operations), and one WFM’s external consultant started to consider a potential merger between the two companies. Thereafter, on April 21<sup>st</sup>, 2017, one WFM’s outside consultant contacted Jay Carney, Amazon’s Senior Vice President of Corporate Affairs, to inquire whether Amazon’s representatives were interested in a meeting to discuss a potential strategic transaction. As a result, after three days, Amazon’s Vice President of Worldwide Corporate Development, contacted the same consultant indicating their interest in an exploratory meeting between the two parties<sup>96</sup>.

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<sup>95</sup> Hansen (2001), presents a useful model to analyze the competition among bidders prior to the public announcement of an offer(s).

<sup>96</sup> During the negotiation process, we emphasize Amazon’s efforts to both maintain the secrecy about the deal, and avoid the initiation of an auction for WFM. Prior to the public announcement, in order to maintain the secrecy about Amazon’s intentions, WFM was referred as “Walnut” to its advisors. Plus, on April 27<sup>th</sup>, 2017,

Simultaneously, on April 18<sup>th</sup>, WFM received a letter from an industry participant (“Company X”<sup>97</sup>) communicating its interests in exploring strategic opportunities and a potential partnership. In the following two weeks, WFM and Evercore Group LLC (WFM’s financial advisor at the time) also received separate inquiries, from four private equity firms, indicating a potential interest in being involved in a future leverage buy-out, a private investment in public equity (PIPE), or any other transaction in light of Jana Partners’ activism.

On April 30<sup>th</sup>, the respective CEOs of WFM and Amazon, accompanied by other senior representatives, met for the first time in Seattle. Despite the fact that no proposal for a transaction was made, nor was initiated a discussion concerning valuation matters, the meeting served to analyze potential strategic opportunities and areas of complementary capabilities between the both parties. On May 4<sup>th</sup>, representatives of both companies met again (in WFM’s head office) for a full day in-person due diligence session (following this meeting, WFM continued its contacts with Amazon, providing additional data regarding WFM’s operations and other due diligence information).

On May 8<sup>th</sup>, a second industry participant (“Company Y”) inquired WFM about its interest in initiating a conversation concerning a potential business relationship between the two companies.

On May 18<sup>th</sup>, in a meeting with WFM’s representatives, “Company X” expressed its interest in pursuing a merger-of-equals transaction, which they believed would be potentially valued at \$35.00 to \$40.00 per share to WFM’s shareholders. On the same day, in a telephone conversation, “Company Y”

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WFM and Amazon entered into a non-disclosure agreement (subsequently, on May 7<sup>th</sup>, both companies entered into a supplement to this non-disclosure agreement).

<sup>97</sup> As referred in the definitive proxy statement. Due to confidentiality matters, the name of certain companies involved in the negotiation process was not disclosed

communicated its interest in advancing in further discussions concerning a possible commercial relationship (such as a supply arrangement) with WFM<sup>98</sup>.

On May 23<sup>rd</sup>, WFM received the first (non-public) offer made by Amazon. In a written letter the e-commerce giant offered to pay \$41.00 per share of WFM's common stock<sup>99</sup>. On top of that, Amazon reserved the right to terminate the deal if there was any leak/rumor about its offer, and highlighted that its interests (in WFM) were very sensitive<sup>100</sup>.

On May 30<sup>th</sup>, WFM's board met with its advisors to discuss the company's long-term outlook, business plans, its ability to achieve them, and the proposals made to the company (not only the recent discussions with Amazon, but also the previous proposals from "Company X", "Company Y", and the four private equity firms). In this meeting, Evercore acknowledged that the price proposed by Amazon was likely to exceed the price level that a private buyer could reasonably offer. Yet, after revising certain financial analyses, valuation perspectives, and comparing Amazon's offer with its alternatives, WFM's board decided to make a counter-proposal. Later that day, representatives from Evercore communicated a \$45.00 per share counter-proposal to Goldman Sachs.

On July 1<sup>st</sup>, Goldman Sachs' representatives communicated that Amazon was considering other alternatives instead of ceding to WFM's counter-proposal. They asserted that as a last stretch Amazon was willing to offer \$42.00 per share (non-negotiable), and requested that WFM promptly replies to it. As a response, and after

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<sup>98</sup> However, it was not discussed any possible merger or acquisition of WFM.

<sup>99</sup> In M&A a correct price does not exist, rather it exists an interval of possible prices that lead to the conclusion of an acquisition. As long as the price offered falls within the maximum that the bidder is willing to pay (the cap) and the minimum that the target is willing to sell (the floor), it is possible to conclude an acquisition.

<sup>100</sup> On May 25<sup>th</sup>, representatives of Goldman Sachs & Co LLC, Amazon's financial advisor, contacted WFM's financial advisors reinforcing that Amazon sensitivity to confidentiality matters, and that it was not willing to participate in a multiparty sale process. Goldman Sachs also believed that Amazon had submitted a very strong proposal.

consulting its advisors, WFM's board unanimously authorized Evercore to inform Goldman Sachs that the company was willing to move forward to negotiate a transaction at a \$42.00 per share. On the next day, WFM received a written due diligence request list from Amazon, and the legal advisors of both companies started to negotiate the term of the merger agreement<sup>101</sup>. This process extended until July 15<sup>th</sup>, the day in which WFM's board unanimously determined that the merger was fair to, and in the best interests of, the company and its shareholders, and authorized the company to enter into the merger agreement<sup>102</sup>.

Following the "Agreement and Plan of Merger", if the deal was not concluded by February 15<sup>th</sup>, 2018<sup>103</sup>, either party could terminate the deal. Moreover, either firm could terminate the deal if: it was not obtained approval for the deal by WFM's shareholders<sup>104</sup>; or an order permanently restraining/prohibiting the consummation of the deal becomes final and non-appealable. Amazon could also terminate the deal, unilaterally, if WFM's board changed its recommendation prior to the obtainment of its shareholders' approval (however, WFM's board could change its recommendation and/or terminate the merger in response to a superior bid, requiring WFM to give Amazon at least five business days' prior written notice of its intentions, and to give Amazon the opportunity to negotiate)<sup>105</sup>.

Alternatively, it was established that WFM's would have to pay a termination fee of \$400 million in the cases in which: the deal was terminated by Amazon, due

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<sup>101</sup> In order to analyze WFM's projections, as a standalone company, that were considered during the negotiation process see *Annex – 7. Whole Foods Market's Projection*.

<sup>102</sup> In this decision, WFM's board weighted, among others, its prospects, competitive position, historical performance, potential changes in the grocery industry, and investments required to fulfil its long-term plan.

<sup>103</sup> Subject to extension to May 16<sup>th</sup>, 2018, within certain conditions.

<sup>104</sup> In this case, WFM would be required to pay to Amazon all of the reasonable and documented out-of-pocket expenses incurred by Amazon and Merger Sub (in an amount not to exceed \$25 million). See *Annex – 8. Voting results from Whole Foods Market's Special Meeting to approve the Merger Agreement*.

<sup>105</sup> For more details, see Article VIII from the "Agreement and Plan of Merger" (Form 8-k, filled by Amazon on June 15<sup>th</sup>, 2017).

to the change of recommendation by WFM's board prior to the approval of the deal by its shareholders; terminated by WFM (prior to the approval) if the latter enters into an alternative acquisition agreement that provides a superior proposal; or if, within twelve months after the termination of the merger agreement, WFM or any of its subsidiaries enters into a definitive agreement with respect to an acquisition proposal. Large termination fees can be a useful tool to eliminate competing bids, as well as to increase the odds of completing the deal<sup>106</sup>. This way Amazon was protecting its interests and guaranteeing a remuneration for the costs which it had already incurred, such as the ones associated with the due diligence process and the time dispended, in the case of failure of the deal (besides, target's shareholders tend to lose when a sole bidder withdraws its offer).

Thereby, from the information extracted from the merger agreement, we highlight the following effects on WFM's capital stock<sup>107</sup>:

- Each WFM's share of common stock issued or outstanding prior to the date of consummation of the deal (other than WFM's shares owned by Amazon, Walnut Merger Sub, Inc., WFM, or any direct or indirect wholly-owned subsidiary, not held on behalf of third parties), would be converted into the right to receive \$42, without interests;
- Each outstanding stock option and stock appreciation rights (whether vested or unvested), would be automatically cancelled and converted into the right to receive, without interests, an amount in cash equal to the product of the

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<sup>106</sup> There are two opposing strands concerning the inclusion of termination fees. The "principal-agent theory" postulates that termination fees serve managers' private interests (serving as an enhancement of their job security, given that eliminates competing bids). The "efficient contractual device theory" states that termination fees can protect the initial bidder against the costs associated with the free-ride, by competing bidders, on information disclosed by them. Jeon and Ligon (2011), found that large termination fees usually are less beneficial to target's shareholders, leading to the conclusion that some deals might be approved not because it is the most beneficial, but rather to avoid the termination fee.

<sup>107</sup> See *Annex – 9. Aggregate number of securities to which the transaction applies*. For more details, see Article IV from the "Agreement and Plan of Merger" (Form 8-K, filled by Amazon on June 15<sup>th</sup>, 2017).

number of shares subject to the option and the excess (if any) of the merger consideration in relation to the exercise price per share of such option<sup>108</sup>.

- Each restricted stock and restricted stock unit award would be canceled and converted into the right to receive, without interest, an amount in cash equal to the product of the number of shares of WFM’s common stock subject to such award multiplied by the merger consideration.

As a result, the total consideration was estimated to be approximately \$13.57 billion (including WFM’s long-term debt and the total fee paid by Amazon<sup>109</sup>, the total purchase price of the acquisition equals approximately \$14.76 billion).

	<b>Whole Foods Market’s stock price</b> (\$) <sup>1</sup>	<b>Premium</b> <sup>2</sup>
One day prior to the announcement	33.06	27.04%
At the first contact with Amazon	35.71	17.61%
52-weeks (prior to the announcement) high	37.03	13.42%
52-weeks (prior to the announcement) low	27.96	50.21%

**Table 2:** Whole Foods Market’s historical stock price and implied premiums.

Source: Thompson Reuters Eikon Database.

<sup>1</sup> Closing prices.

<sup>2</sup> Implied premium, when compared to the price offered per share from Amazon, \$42.

Note: On June 16<sup>th</sup>, 2017 (the announcement day), was the day in which was registered the highest percentage change in price and high trading volumes on Whole Foods Market’s stock (considering the period from 52-weeks prior to the announcement to the delisting of Whole Foods Market’s shares).

<sup>108</sup> Each option with an exercise price superior or equal to the merger consideration would be canceled without any payment.

<sup>109</sup> Accordingly to Thompson Reuters Eikon Database, Amazon paid a total fee equal to \$25.704 million, while WFM paid a total fee equal to \$45 million (0.19% and 0.33%, respectively, when compared to the total consideration).

Unquestionably, the premium is an indicator of the potential synergetic gains that may come from the merger between two companies. From the table above it is possible to conclude that, in comparison to WFM's stock price one day prior to the announcement, the price offered by Amazon entails a slightly lower premium (27.04%) when compared to other M&A deals in 2017<sup>110</sup>. However, it is important to highlight the premium's sensibility to movements in WFM's stock price. If instead we consider the price at which WFM was trading at the moment in which the companies engaged in negotiations, it is possible to observe a considerable decrease on the offer's implied premium. During the two months prior to the announcement, WFM's was stably trading at similar levels from the one at the first contacts with Amazon. Conversely, during the week preceding the announcement, WFM's stock price, accompanying the general shock that was observed in the market, suffered a substantial decline. For this reason, in our opinion, the evaluation of the premium offered by considering the price at which WFM was trading one day prior to the announcement may not be the most appropriate one (rather, in our opinion, Amazon's offer should be compared against WFM's stock price as in the first contact between the two companies, which implies a premium equal to 17.61%). Lastly, it is also possible to affirm that, given the closeness between the 52-week high and to the average stock price at which WFM's was trading, the probability of overpayment is reduced in this case<sup>111</sup>.

Alternatively, in order to evaluate the fairness of Amazon's offer, we conducted a multiple valuation of WFM's enterprise value and price per share<sup>112</sup>:

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<sup>110</sup> Following McKinsey, the average premium offered in 2017, was above 30%.

<sup>111</sup> See Alexandridis et al. (2013).

<sup>112</sup> See *Appendix – 3. Multiples Valuation of Whole Foods Market*. We remember that in this study we will not focus on evaluating which part of the premium can be attributed to the acquisition's synergetic gains nor to value control.

	<b>Peer's Average</b>	<b>Implied Enterprise Value<sup>1</sup> (\$, Millions)</b>	<b>Implied Share Price<sup>3</sup> (\$)</b>
EV / 12M FWD EBITDA	8.975	11,761	35.95
EV / 12M FWD Sales	0.544	8,864	26.90
Dividend-Yield (%)	1.917	12,278	37.57
Price-to-Book Value of Equity	3.835	13,518	41.44
<b>Average</b>	-	<b>11,605<sup>2</sup></b>	<b>35.46<sup>4</sup></b>

**Table 3:** Multiple valuation of Whole Foods Market.

<sup>1</sup> WFM's Enterprise Value on June 6th, 2017 (computed as the sum of its market capitalization and total debt, minus cash & equivalents): \$11.458.370.000.

<sup>2</sup> Implied premium, in comparison to the total consideration: 16.94%

<sup>3</sup> WFM's share price on June 6th, 2017: \$34.73.

<sup>4</sup> Implied premium, in comparison to the price paid per share: 18.44%

From the table presented above, it is possible to conclude that, from a financial perspective, Amazon's offer was fair. By comparing the average implied WFM's enterprise value and stock price to Amazon's offer, the implied premium ranges from 16.94% to 18.44%. For this matter, it is possible to find in the literature several authors linking higher premium with greater long-term performance. However, we can fundament the lower premium paid by Amazon with the following arguments<sup>113</sup>: (1) WFM's size, i.e. usually, the larger the target's size, the smaller the premium offered; (2) small competition to acquire WFM, plus Amazon's strengths, resources, and complementarity probably makes them the best option to merge; (3) and WFM's small bargaining power. In spite of the small premium,

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<sup>113</sup> Other factors that may influence takeover premium: prior stock market returns and its volatility; market misvaluation; momentum in takeover premium; etc. See Simonyan (2014).

relying on the rationales presented above, at this point one can logically expect that the merger of the two companies generates significant wealth increases.

#### 4.3.4. Market Reaction to the Acquisition

The public announcement of the takeover attempt, on June 16<sup>th</sup>, 2017, gave rise to much debate and caused rivers of ink to flow. Meanwhile, the acquisition came at the same time of other important news to the food retail sector. The entrance of German retail giant Lidl in the U.S., and the alarms sent by the Kroger's profits turn the markets very sensitive to adverse news. At the announcement, several articles took the risk to say that this event could disrupt this stable industry, and that Amazon was the most suitable firm for turning around WFM's recent trend. Furthermore, the public announcement of the offer was in harmony with the activism flow conducted by the hedge fund Jana Partners LLC (which was advising WFM to look for some potential merger in the months prior to the announcement).

Even though the market's reaction (i.e. investors' perspectives about the value that would be created/destroyed through the deal) does not necessarily equal success or failure in M&A, its understanding constitutes a key indicator about the quality of the acquisition<sup>114</sup>. Healy (1992), for example, provides evidences "that there is a strong positive relation between postmerger increases in operational cash-flows and abnormal stock returns at merger announcements". However, in order to fully perceive the wealth effects of an acquisition, the researcher should not limit himself to a single moment. As it was discussed in previous sections, prior to the announcement of the acquisition, the target's (and/or the bidder's) share price can

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<sup>114</sup> The effects on stock prices, at the announcement, only reflect the true value of an acquisition if the assumption that the markets are efficient (in the strong-form) holds. See Malkiel (1989), Fama (1998), and Schwert (2003).

already reflect the expectations about a potential acquisition<sup>115</sup>. Previous run-ups might reflect the inclusion of the synergies' discounted value. Plus, the larger the run-up prior to an acquisition, the larger the costs will be to the bidder (run-ups in the target's share price are "financed" by the bidder's share of total synergies). Betton et al. (2014) provided evidences that run-ups in the target's price are not offset (dollar-by-dollar) by a decrease in the markup, i.e. in their model "the run-up/mark-up relation is always greater than minus one-for-one, is inherently nonlinear, and may even be positive". This lead us to the conclusion that less anticipated bids tend to generate higher returns, and that after accounting for anticipation effects, bidding can actually be a significant wealth-creating event for the bidder.

On top of that, one should include rivals' price movements on his analysis. Only this way the researcher can obtain a complete idea of market's reaction to an acquisition. In fact, some companies may possibly weigh market's reactions in their choices. Another factor that stands out is that investors usually reward acquirers that disclose detailed information about the value-drivers of a given deal. Resorting to literature, it is possible to find evidences that some deals' characteristics, such as the relative size of the target, the payment method and the type of target influence investors' reactions to an acquisition<sup>116</sup>.

As it is perceptible by analyzing both parties stock price movements, investors perceived Amazon's acquisition as good news. In more detail, on June 16<sup>th</sup>, 2017, both WFM's and Amazon's stock prices rose: 25.54% and 2.41%, respectively<sup>117</sup>. To this regard, we remember that such a positive reaction, by the bidder's

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<sup>115</sup> Run-ups do not necessarily mean inside trading. This phenomenon may occur due to informed investors, based on public information, perceiving some signals that a company will be a target.

<sup>116</sup> See footnote 33.

<sup>117</sup> Generating an abnormal-return of 25.62% and 2.79%, respectively. Despite the abnormal-return generated by the acquisition to Amazon does not seem substantial, it corresponds to a significant change in absolute terms. Plus, we also have to remember that these returns was generated during a short time period, i.e. one trading day.

shareholders, to the announcement of an acquisition constitutes an “uncommon” event (relying on the literature, bidder’s shareholders tend to react negatively to when the company announces an acquisition). For that reason, it is possible to conclude that the increase in Amazon’s share price happen due to the market’s perception that the price paid per share was inferior to the value of the target (standalone), plus the discounted value of the potential synergies from the deal, representing an indicator of the potential wealth-creation that can be generated by the merger between the two companies.

Conversely, WFM’s competitors, such as Walmart, Target, and Sprouts Farmers, experienced negative stock returns at the announcement: -4.76%, -5.28%, and -6.50%, respectively. This occurrence is perfectly aligned with competitors’ fears of the entrance of Amazon in a given sector (similar reactions could be found when Amazon entered in the pharmaceutical industry<sup>118</sup>). Notwithstanding, many argued that the severe drop in competitors’ stock prices were excessively negative. Despite Amazon’s competitive advantage, due to its reach, expertise and fast-delivering services, these grocery companies were also strengthening its e-commerce segments/presence<sup>119</sup>. Another argument was that big-box stores will “survive”. A big part of the customers still prefer to see/touch the products that they buy (especially WFM’s loyal customers, which were identified as customer worried about the origin of the products or a specific diet). This feature raised even more questions about the portion of customers that would start buying their groceries online.

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<sup>118</sup> See <https://healthcareweekly.com/amazon-buys-online-pharmacy-pillpack/>

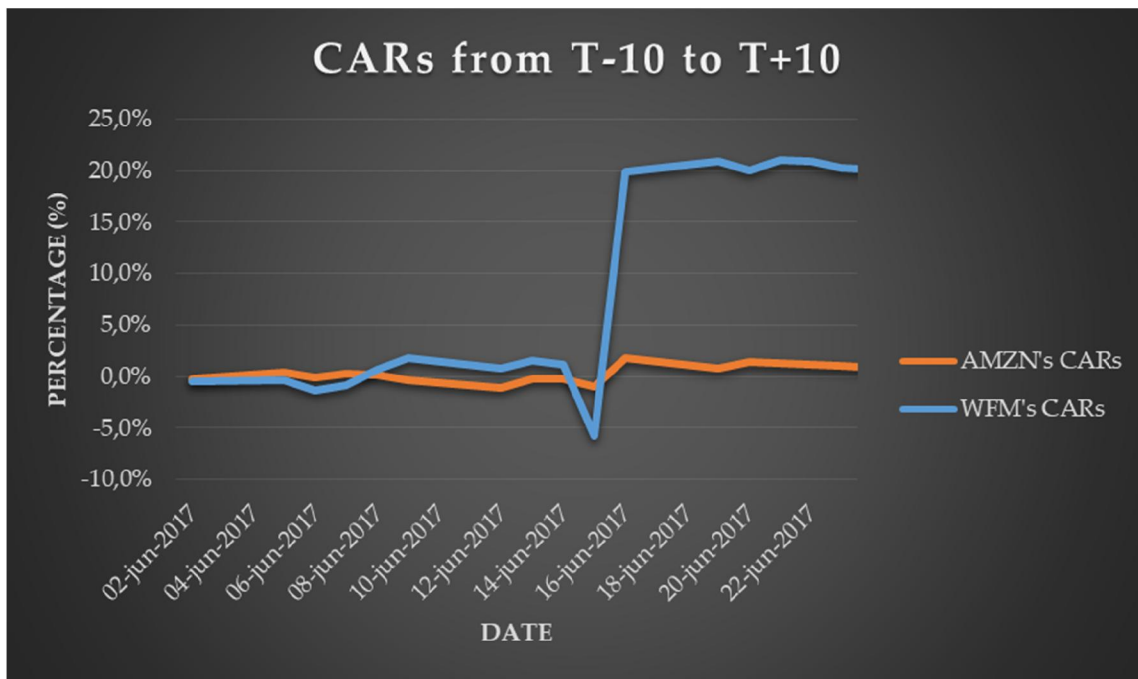
<sup>119</sup> Walmart, for example, acquired some smaller online firms, such as Bonobos, Jet.com, Mod Cloth, or Moosejaw.

In order to deepen our understanding about the impacts of the acquisition on both companies' returns, we also computed the cumulative-abnormal-returns (CARs)<sup>120</sup>.

	Whole Foods Market	Amazon
CAR (T-10, T+10)	18.85%	0.42%
CAR (T-49, T+10)	33.92%	1.36%

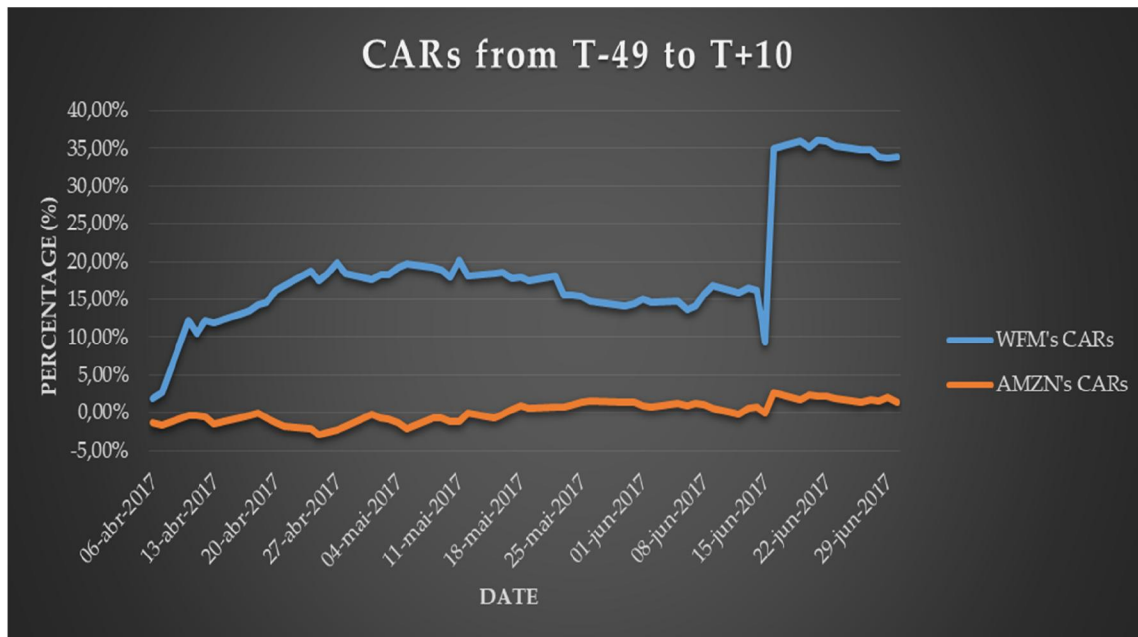
**Table 4:** Cumulative-Abnormal-Returns (CARs).

Graphically:



**Graph 1:** Cumulative Abnormal Returns (T-10; T+10)

<sup>120</sup> See Appendix – 4. Cumulative-Abnormal-Returns (CARs). Nevertheless, we reinforce that looking solely to short-term reactions may lead to wrong conclusions, given that they only represent expectations, not actual value creation. Also, CARs may underestimate the value added by multi-deal strategies, whose real worth develops over the long-term. In order to have a clear picture of the value-creation in M&A, one should also analyze the long-term effects on profitability, and comprehend what will drive value-creation (rationales).



**Graph 2:** Cumulative Abnormal Returns (T-49; T+10)

In line with what was previously said in this study, from our analysis it is possible to conclude that: the announcement of the acquisition created a substantial return to WFM's shareholders (anticipating significant wealth-increases from the merger between the two companies). On top of that, by analyzing the second graph, we can conclude that the set of operations that led to the acquisition (i.e. including the pre-announcement phase) also generated significant abnormal-returns to WFM's shareholders. In this matter, as it was indicated before, prior to the acquisition WFM not only was being targeted by Jana Partners (which intended to engage in active discussions with WFM's board of directors and management), but also had announced a set of restructuring operations that influenced the investors' prospects for the company<sup>121</sup>. However, there are no evidences that WFM's stock price was already including the discounted value of the wealth increases that would be created by merging with Amazon. Our conclusion is that, despite the fact that

<sup>121</sup> We remember that this prior run-ups could have increased the costs (price paid) to Amazon.

informed investors' revaluations of WFM could already anticipate some kind of future operation between WFM and another party, Amazon's offer was unanticipated.

By examining both graphs presented above, the acquisition did not appear to generate any significant abnormal-return to Amazon's shareholders (also it does not appear to exist any evidence of anticipation of the deal). Yet, we have to remember that, given the relative size of the two companies, a percentage change on Amazon's stock price cannot be directly compared to a percentage change, in the same amount, on WFM's stock price. On the other hand, if we compute the average abnormal-return for the next 20 trading-days after the announcement of the acquisition, it is perceptible that this event was, in fact, a significant wealth-creating one to Amazon. Concretely, the acquisition generated an average supernormal return equal to 0.088%<sup>122</sup>. At first glance, this return may not seem substantial. However, we have to remind that this return relates to a short very period (one trading-day). Alternatively, we also hypothesize the fact that Amazon's stock price may already include a premium related to its M&A activity ("*serial acquirer premium*"). In other words, if we consider Amazon's success on the series of acquisitions engaged by them in the previous years, and the role that acquisitions play on Amazon's strategy, we raise the possibility that Amazon's stock price may already include the anticipation of future bids (plus its contribution for Amazon's success)<sup>123</sup>. As a result, if this hypothesis holds, our analysis, as well as similar studies focused on other Amazon's acquisitions, may underestimate the market's reaction to the announcement of an acquisition by the company.

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<sup>122</sup> 24.92%, in annual terms.

<sup>123</sup> Following Leaman et al. (2004), the market tends to reward serial acquirers. The authors also provide empirical support for the advantages of a dynamic M&A strategy over the long-term (compared to one-time acquirers).

To conclude this section, we also emphasize the speculation about a competitive (superior) bid on the days following the announcement. Many of the attentions were turned especially to Walmart, as some investors speculated that the world's largest retailer would respond to the announcement with an offer (in fact, WFM's shares were trading above the price offered by Amazon)<sup>124</sup>. Yet, neither Walmart, nor any other company, showed any visible sign (at least to the public) about considering making any offer.

#### 4.3.5. Merger

The form used to incorporate WFM into Amazon's ecosystem can be classified as a reverse triangular merger. Walnut Merger Sub, Inc. (an indirect wholly owned subsidiary of Amazon.com which, apart from its formation and the activity related to the acquisition of WFM, did not had any other activities)<sup>125</sup>, was the third participant in the transaction. In more detail, the organic food chain merged with Walnut (the special-purpose-vehicle) and continued to exist. As a result of this operation, WFM became a subsidiary to Amazon. Another aspects about this operation important to highlight here are the fact that WFM continued to operate its stores under WFM's name/brand, and that John Mackey maintained his functions as CEO of WFM<sup>126</sup>. Conversely, individuals holding positions as directors of Walnut at the effective time would become the initial directors of the surviving corporation.

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<sup>124</sup> More specifically, its share price exceeded Amazon's offer by more than \$1.5.

<sup>125</sup> After the completion of the deal, each share of common stock (100 shares, par value \$0.01) of Merger Sub would be converted into one share of common stock (par value \$0.01 per share) of the surviving company.

<sup>126</sup> The maintenance of the incumbent management teams/directors constitutes a common practice among friendly acquisitions, and facilitates the integration process. On the other hand, and despite WFM's recent changes on its boards, Amazon requested (accordingly to the "Agreement and Plan of Merger") that WFM used its commercially reasonable efforts to cause the resignation of some of its, or its subsidiaries, directors. It is also important to highlight that, on May 9<sup>th</sup>, 2017, WFM performed several changes on its board.

From a financial perspective, the use of special-purpose-vehicles (SPVs) can be an effective tool to manage parent firm's risk exposure. In other words, SPVs usually serve to protect the parent company in case of bankruptcy, loan default, or any loss on these assets. Concerning our case, we identified two rationales that support Amazon's decision to include a third part in the deal, namely: to facilitate the tracking of the financials related to WFM, and to facilitate the "transfer" of the innumerable WFM's permits and contracts<sup>127</sup>.

Complementary, the merger agreement contained certain pre-closing covenants. From these, we highlight covenants concerning (within certain conditions): the conduction of WFM's activity in its ordinary course, and the refrain of initiating certain activities without Amazon's consent; restructuring operations for WFM's and its subsidiaries; the issuance/sell/transference of WFM's and its subsidiaries shares, and the issuance of any debt security, by WFM; covenants not to solicit or negotiate any other bid, or provide non-public information with alternative bidders (WFM and its subsidiaries should also notify Amazon if any proposal/indication of interests was received); and covenants requiring WFM's board to recommend WFM's shareholders to approve the deal<sup>128</sup>. On the other hand, it was not imposed any action/restriction to Amazon with respect to any asset/operation/business of Amazon's, WFM's, or any subsidiary, other than divestiture of certain WFM's assets.

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<sup>127</sup> Additionally, the use of SPVs is commonly linked with legal and tax considerations. However, these topics will not be our focus in this study, for more detail see, for example, Hartgraves (2002).

<sup>128</sup> For more details, see Article VI from the "Agreement and Plan of Merger" (Form 8-k, filled by Amazon on June 15<sup>th</sup>, 2017).

#### 4.3.6. Going-Private Decision

In line with the previous section, afterward the conclusion of the deal, WFM was delisted from NASDAQ and deregistered under the Exchange Act<sup>129</sup>. Going-private announcements are usually perceived as good news. One of the arguments that support this perception is the potential value increases enabled by private ownership. DeAngelo (1984) provided evidences that, in an M&A context, target shareholder experienced wealth increases after going-private. Also, Jensen (1986) claims that going-private could be used to align managers' interests and improve the monitoring within a company, leading to efficiency gains. Private companies can also benefit from savings of registration and other public ownership expenses (especially, after the approval of the Sarbanes-Oxley Act (SOX)<sup>130</sup>, public firms' disclosure requirements and penalties increased). In our case, the delistment of WFM's allowed Amazon to profit from economies of scale concerning public registrations.

Another important aspect with the delistment of a given company is related to the avoidance of certain constraints of the public capital markets. In line with what was previously said in this study, listed companies are more exposed to public investors' short-termism (especially when firms start to mature and see their growth decelerate)<sup>131</sup>. Their demand for quick payoffs (short-term earnings

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<sup>129</sup> This decision affects WFM's information available to the public, constraining our ability to analyze WFM's performance after the deal.

<sup>130</sup> Approved in 2002, the SOX had in mind the enhancement of investors' confidence in the U.S. capital market. For more detail about SOX's implications, and about its main provisions, please see Engel et al. (2007) and Kamar et al. (2007).

<sup>131</sup> Hackbarth et al. (2018), classify short-termism as another dimension of the agency costs of debt: "Less long-term effort reduces the risk of investment benefits being largely reaped by bondholders and also make it cheaper for shareholders to incentivize more short-term effort". The authors also defend that there may have optimal levels of short-termism, stating that it might be "desirable for shareholders of a financially distressed firm financed with debt".

growth/performance) frequently conditions firms' ability to take (optimal) long-term value enhancing operations.

On top of making it easier for companies with good growth perspectives to invest in the long-term, going-private also prevents "public scrutiny" concerning certain decisions. Often, companies which have been bought and went through the process of going-private, increase their restructuring operations<sup>132</sup>. More specifically, these companies commonly conduct divestment operations, either by selling assets or by exiting from a less productive segment (which might indicate that some listed companies are affected by agency problems).

We also point out one key difference between our case and those which do not stem from any merger or acquisition (e.g. when public corporate ownership is replaced by full equity ownership by the incumbent managers). Many argue that the latter might not be beneficial for the company, due to the reduction of its future financing alternatives (namely, the equity market). In our case, we cannot say that WFM fully departed from the equity market, given that, after the acquisition, the organic-food chain become "indirectly" quoted through Amazon.

Lastly, we emphasize that this operation might be merely a transitory process. Frequently, after the implementation of several corporate restructuring operations, many companies reverse the process of privatization. In other words, the privatization of a given company may enable the avoidance of a certain turmoil during the execution of certain restructuring operations. Having this in mind, we do not rule out the hypothesis of future initial-public-offer for WFM.

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<sup>132</sup> According to Bharath et al. (2014), firms that went private also decrease employment and capital investments.

## 4.4. Post-Acquisition

One of the major causes that lead to failure in M&As is the lack of capabilities to integrate the acquired firm<sup>133</sup>. The “numbers” presented before the completion of an acquisition can rapidly change. Also, time is a silent killer of deals. Investors tend to penalize a company if the results from an acquisition take too long to appear (if they appear at all). The more a company delays the integration process of a company, the more difficult it would be to capture certain synergies, and more able would its competitors be to close the gap created by the acquisition<sup>134</sup>. Having this in mind, we reserve this section to explore some of Amazon’s post-acquisition actions that contributed for the integration of WFM.

On the verge of the conclusion of the deal (on August 28<sup>th</sup> 2017), the two companies announced that on the first day of the “marriage” the prices of some selected groceries would be lower<sup>135</sup> (with the guarantee of maintaining the quality) and that WFM’s brands products<sup>136</sup> would become available on Amazon.com, Amazon Fresh, Prime Pantry and Prime Now. Among the changes that were anticipated to be implemented at WFM, we highlight: the integration of Amazon Prime into WFM’s point-of-sale system, allowing prime members to obtain special in-store benefits; Amazon Prime would be the WFM’ customers new reward program; and the introduction of the “Amazon Lockers” in some selected WFM’s stores. The latter, would give to the customers the possibility to collect their products

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<sup>133</sup> WFM’s size adds complexity to the deal (more difficult to integrate). Yet, following the literature, a deal’s potential synergies tend to increase with size.

<sup>134</sup> Following the work developed by Uhlenbruck et al. (2016), accounting for the rivals’ actions in response of an acquisition is essential to have a full perception of the operation. Rivals can exploit some distraction of the acquirer in order to limit or eliminate an acquirer’s competitive advantage or gains.

<sup>135</sup> With this announcement, WFM’s competitors suffered again a decline in their stock prices.

<sup>136</sup> 365 Everyday Value, Whole Foods Market, Whole Paws and Whole Catch.

ordered from Amazon.com on a WFM's store, as well as send returns back to Amazon<sup>137</sup>.

Amazon stated that its focus would be "to make high-quality, natural and organic food affordable for everyone"<sup>138</sup>. To the public, the last part of this statement represented an obvious move after the acquisition. WFM was known to have significantly higher prices than the average grocery store. In fact, according to Morgan Stanley, WFM's prices were approximately 15% higher than its competitors. Many believed that the key for Amazon's success on this competitive sector would strongly rely on its well-known ability to cut costs.

One day after Amazon took control of WFM it was already possible to read some feedbacks given by WFM's usual shoppers. To them, it was not perceptible any difference in terms of prices in the organic food chain. Yet, who reported these opinions emphasized the fact that this acquisition was undoubtedly a long-term play. Stephen Beck, owner of a management consulting firm in New York stated "This isn't about groceries anymore. It's about pulling people into the Amazon ecosystem. All the signs in the store are saying, 'Look at what Amazon's doing for you'."

On the bright side, the announcement of price cuts attracted more customers to WFM. Amazon was already a big threat to other retailers. With its entrance in brick-to-mortar stores, it was reported a decrease in the foot traffic in several competitors. Following the research firm Thasos Group "foot traffic jumped by

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<sup>137</sup> For more details, please see [https://www.amazon.com/b/ref=s9\\_acss\\_bw\\_cg\\_wfmex\\_2a1\\_w?node=644260011&ref=wk\\_wfm\\_em\\_l&pf\\_rd\\_m=ATVPDKIKX0DER&pf\\_rd\\_s=merchandised-search-8&pf\\_rd\\_r=5RWNI5MDSGHXPX4F6DK3&pf\\_rd\\_t=101&pf\\_rd\\_p=3db57c1f-7ff0-4352-9f63-b3e7bc825611&pf\\_rd\\_i=17235386011](https://www.amazon.com/b/ref=s9_acss_bw_cg_wfmex_2a1_w?node=644260011&ref=wk_wfm_em_l&pf_rd_m=ATVPDKIKX0DER&pf_rd_s=merchandised-search-8&pf_rd_r=5RWNI5MDSGHXPX4F6DK3&pf_rd_t=101&pf_rd_p=3db57c1f-7ff0-4352-9f63-b3e7bc825611&pf_rd_i=17235386011)

<sup>138</sup> One of the company's first moves after the acquisition was to enter into several supplier commitments (non-callable) with some WFM's previous suppliers.

roughly 33% in the first week”, stating that “24% of new Whole Foods customers were previously loyal Walmart customers”. Concerning other grocery chains, Thasos Group informed that Trader Joe’s, Sprouts and Target Corp, saw 10%, 8% and 3% of their customer base, respectively, go to a WFM’s store<sup>139</sup>. At this point, the general consensus was that Amazon should continue to make an effort to cut prices at WFM to attract more customers to its “new” physical stores.

Throughout the first month after the conclusion of the deal, Walmart made some price cuts on its products as a direct response to Amazon. Furthermore, Walmart’s subsidiary Jet.com<sup>140</sup> publicized the launch of a new brand, Uniquely J, dedicated to younger customers (as it was previously said, a considerable part of Amazon’s customers are the “millennials”). This move reveals that Walmart was willing to invest and compete with Amazon on its own “backyard”<sup>141</sup>.

On October of that year, and after the first impact of the deal, it was already possible to have a different perspective about it. Since the conclusion of the acquisition, approximately \$1.6 million of WFM’s products were sold on Amazon website and its related services. However, less satisfying news started to emerge concerning the WFM’s groceries prices. During this time window, several products had seen their prices return to previous levels, resulting into a drop of only 1.2%. Gordon Haskett Research Advisors tracked prices of about 110 items, during five weeks at a Whole Foods in Princeton, and concluded the following: the price of 17 items declined, the price of 16 items raised, and the remaining ones did not show any significant change. They denoted too that the majority of marketdowns were in

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<sup>139</sup> Similarly, Orbital Insight and Foursquare reported that both parking lot and in-store traffic increased in the days following the announcement.

<sup>140</sup> A fast-growing online retailer bought by Walmart for \$3bn., in 2016.

<sup>141</sup> Walmart has also reach an agreement with Google, enabling its customers to make their orders by voice on Google devices (competing with Amazon’s Alexa), and an agreement with Uber Technologies Inc. to enhance its grocery delivering service.

products with a higher profit margin and in products that families tend to buy frequently. To Jan Kniffen, an industry consultant and former department store executive, “The whole game is that you want the 100 most recognizable things [...] to be cheaper”; “If you can do that, you can build a perception that the whole store is competitively priced”. Indeed, in this context, perception matters a lot. As long as the customers feel that they are getting a good deal, price is not a major problem<sup>142</sup>. Notwithstanding, in the next month Amazon showed once again its commitment to lure more customers to WFM and fulfil its initial promises, by announcing a second round of price cuts in some selected WFM’s products.

The year of 2018 began with some adverse news to Amazon. Its “new” competitors presented a sales increase accompanied by a good stock performance. Additionally, they were also reinforcing their click-and-collect programs and investments in cashierless-technologies. In this respect, Jeremy Bowman emphasized the complexity of the challenges that Amazon would face with this acquisition, remembering that it is “hard to rewrite the rules of an industry with such a small slice of the pie”. Simultaneously, some WFM’s stores were facing difficulties in managing its in-store stocks.

On February 2018, Amazon added one of its strengths to WFM. In particular, Amazon offered its Prime Members the possibility to receive their orders, from Prime Now app and Amazon’s website, within two hours<sup>143</sup>. This event was described in the news as Amazon’s biggest move since it acquired WFM. Even though this feature was only available in some cities, Amazon had intentions to extend it countrywide. When we get together this announcement with the data revealed by NPD Group, we can really understand the importance of this move.

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<sup>142</sup> A strategy that many believed to be perfectly managed by Walmart.

<sup>143</sup> This service was only available during WFM’s work schedule, and in orders superior to \$35 no extra-fee was charged. However, if the customer opted for a one-hour delivery it would be charged an additional \$8 fee.

Jointly with its predictions of a strong growth for online grocery sales, the market research company also stated that around 7% of American households have already shopped groceries online in 2017 (with 75% of these being delivered at home).

In this area, Amazon could effectively gain from its competitive advantage. Despite the actions of WFM's competitors (as the ones, previously referred, took by Walmart, the acquisition of Shipt by Target, promising same-day deliveries, or the trials conducted by Kroger about home delivery), Amazon was already prepared to give response to one of the major reasons for people to shop online: its convenience. According to a survey done by Walter Sands Communications, this was the second most cited reason to shop online, with 23% of the responses, only after the perception of being less expensive, with 40%.

One important aspect that we have to highlight here is the success of WFM's private brand after the acquisition. One Click Retail<sup>144</sup> advanced with the information that 365 Every Day Value was already the second most sold private brand by Amazon. However, a couple of problems were also pointed out on the news about how the two companies were operating. On the one hand, it was still possible to order products from WFM's competitor Sprouts Farmers Market through Amazon's Prime Now. On the other hand, WFM's products could still be delivered by Instacart in some cities in the United States<sup>145</sup>.

On February 20<sup>th</sup> 2018, another important announcement was made. Prime members were now able to benefit from a 5% cashback in all WFM purchases when using the Amazon Prime Rewards Visa Card<sup>146</sup>. Similarly, non-prime members

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<sup>144</sup> A firm specialized on the treatment of e-commerce data, sales measurement and search optimization.

<sup>145</sup> Prior to the acquisition, WFM established a partnership with Instacart, a company which provides delivery services, in order to expand its distribution channels.

<sup>146</sup> Amazon Rewards Visa Cards were launched in the beginning of 2017, in a partnership with JP Morgan Chase & Co and Visa Inc. For more information, see <https://media.wholefoodsmarket.com/news/prime-members-now-earn-5-back-when-shopping-at-whole-foods-market-using-the> and

could also benefit from a 3% cashback in the same purchases. Besides the increased probability of locking its customers, Amazon was really showing its efforts to compete with other grocery chains. Walmart, for example, already had its own credit card program which allowed, among others, its shoppers to spare 3% on Walmart.com (including grocery pickup purchases).

On April 2018, new insides emerged about the evolution of WFM's products prices. Morgan Stanley, which has been accompanying a basket of WFM's products since 2014, concluded that although the cost of the basket at WFM was on historical minimums (registering a drop of about 5.3%, year-over-year), it remained more expensive than those bought at Kroger or Sprouts Farmers Market. It also denoted that the same basket would be cheaper if it was bought to "regional conventional food retailers". However, there are two factors important to take into account. First, some costs incurred by WFM's suppliers have rose during this period. Second, Morgan Stanley highlighted that there were clear signs that WFM was on the road to recovery. This idea is supported by the fact that WFM's basket recorded a bigger decrease in price, than Kroger and Sprouts Farmers (these recorded a drop of 1.7% and 1.1%, respectively, during the same time period). Complementarily, on an article from the Business Insider, it was possible to perceive the intensification of the price war lived at the time. Whereas Amazon was making efforts to close the gap between its in-store prices and those from its competitors, the latter were making similar efforts in their online platforms<sup>147</sup>.

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[https://www.amazon.com/iss/credit/rewardscardmember/ref=s9\\_acss\\_bw\\_cg\\_WPFUNREC\\_3a1\\_w?plattr=CBC\\_CWPF&pf\\_rd\\_m=ATVPDKIKX0DER&pf\\_rd\\_s=merchandised-search-1&pf\\_rd\\_r=RSNN11Z93HA3SDT674VF&pf\\_rd\\_t=101&pf\\_rd\\_p=896fae6d-32fc-4570-a06a-6c5062bf916a&pf\\_rd\\_i=17599167011](https://www.amazon.com/iss/credit/rewardscardmember/ref=s9_acss_bw_cg_WPFUNREC_3a1_w?plattr=CBC_CWPF&pf_rd_m=ATVPDKIKX0DER&pf_rd_s=merchandised-search-1&pf_rd_r=RSNN11Z93HA3SDT674VF&pf_rd_t=101&pf_rd_p=896fae6d-32fc-4570-a06a-6c5062bf916a&pf_rd_i=17599167011)

<sup>147</sup> According to the same article, Walmart and Target, were now price-matching 53% and 35% (respectively) with Amazon's online prices.

The general consensus, until this date, was that WFM's stores did not change significantly. Still, Amazon's efforts to expand the two-hour deliver service and the special opportunities in-store destined to its Prime members continued to make headlines. As expected, Amazon Prime membership was having a fundamental role in Amazon's plan. As it was shown in the past, this "unifying product" continued to be an important factor for Amazon's growth. Despite the announcement of a future increase in its annual fee<sup>148</sup>, on April 2018, Jeff Bezos announced that the number of Prime Members reached the mark of 100 million subscribers worldwide<sup>149</sup>.

One year after the announcement, several reports emerged with a complete analysis of the changes at WFM's stores as well as the company integration into the Amazon's "ecosystem". The acquisition had already shaken the way people perceived online groceries purchases. Many believed that the entrance of Amazon in the food industry had enhanced the percentage of American households that buy their groceries online<sup>150</sup>. Amazon also proved that it was possible to make profits with a basket of products with a much smaller size than it was thought. More, the competition triggered by its entrance makes the consumers the real winners.

One interesting conclusion after one year was the fact that WFM's gains in terms of foot traffic had been made at the expense of small grocery retailers (in particular from the ones located near WFM's stores in more-urban locations)<sup>151</sup>. Big chains, like Walmart and Kroger did not feel any significant loss. Nevertheless, these two rivals have made huge investments to maintain their advantage. The next move

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<sup>148</sup> An increase by 20% to \$119, annually.

<sup>149</sup> Amazon does not disclose any detailed information about its Prime members. Apart from this information, we can only rely on estimates.

<sup>150</sup> NPD Group reported a raise from 6% to 16%, from the beginning of 2017 until half of 2018 (considering home deliveries and click-and-collect).

<sup>151</sup> WFM's "new" loyal customers represented 3% of its customer base.

expected from Amazon was to make long-term investments which would give them the possibility to gain market share to the detriment of these big grocery chains<sup>152</sup>.

Declarations of John Mackey affirming that the “customers have already saved hundreds of millions of dollars” may lead us to conclude that the first year of the “marriage” was truly beneficial for WFM’s customers. Yet, these “savings” came at the expense of the quality of the product, in the opinion of several previously loyal customers. Many noticed a decrease in the quality of the products and even that some of them were no longer available at WFM<sup>153</sup>. The question about if the “premium” paid for WFM’s products was really worth it was, consequentially, reinforced.

On August 2018, another big innovation was introduced in WFM’s stores. In order to draw more clients to WFM’s stores and increase its number of online grocery orders, Amazon announced that, starting in some states (and with the vision to expand it nationally), WFM’s stores would have a new pickup point service. Amazon and WFM compromised to accomplish this service within 30 minutes, and only required the customers to park in a designated area and an employee would bring them their order (the payment would be made automatically from their Amazon’s account). More, through Amazon Echo devices<sup>154</sup>, the customers could “talk” with Alexa, a virtual assistant, to add products to their shopping list, facilitating even more the process of buying groceries.

On September, new problems emerged for Amazon. WFM’s workers were making statements that could compromise the success of the integration of WFM into Amazon. One of the founders of the Whole Worker Community said: “No one

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<sup>152</sup> Since the conclusion of the acquisition, Amazon announced several times the expansion of its physical stores and services, and the reinforcement of its working force.

<sup>153</sup> The investment bank Barclays referred to this change as the “conventionalization” of Whole Foods Market.

<sup>154</sup> These devices would also be available at WFM’s stores.

trusts Amazon and there are fears in upper management that Amazon will clean house if sales rates aren't hit". Since the takeover, some classes of jobs were being progressively eliminated. Therefore, many feared that Amazon was trying to transform them into "robots". WFM's workers were "expected to do more with restricted labor budgets". Other employees stated that "local and specialty products have been cut and replaced with more conventional mainstream ones and regional marketing and sign making has been removed"<sup>155</sup>.

Later on that same year, WFM came at last in a study concerning the chemicals used in packaging hot-food on the top 5 U.S. grocery chains. However, this study gave WFM an opportunity to show the public that the company did not distance itself from its roots and that the general welfare was still a concern. As a response, WFM immediately removed all the materials causing these problems and started focusing on finding sustainable alternatives.

Burt Flickinger III<sup>156</sup>, stated on November 2018 the following: "To Amazon's credit, they've had a few price reductions, including for Amazon Prime members. But Amazon has not, to this point, been able to leverage its size, scale, skill in procurement and buying power to effectively lower prices much." On the same wave length, despite being considered the first grocery chain to successfully sell organic and natural products at a large scale, to many WFM continues to be a "niche player" (which also reinforces the task of rewriting the rules of the food industry).

At the end of the year, Instacart announced an agreement with WFM to dissolve their partnership. As it was said by Tom Forte, an analyst with D.A. Davidson, "Amazon's intent from day one [...] was to integrate WFM with its own

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<sup>155</sup> These news came in line with other news reporting the fact that Amazon was testing its cashierless-technology. Yet, Amazon has denied plans to implement this technology into WFM's stores.

<sup>156</sup> A managing director of Strategic Resource Group, a retail consulting firm.

grocery-delivery efforts such as Amazon Fresh and Prime Now". This seems like a logical move. The problem for Amazon was that Instacart added dozens of new retail partners and had constructed a service that allows them to use customers' data. To Amazon, this could represent the strengthening of its competitors, since by associating with Instacart, they would be able to access data that would enable them to better target customers' preferences and needs.

The year of 2019 began with some announcements that show Amazon's focus on its strategy. On one hand, WFM launched digital catalogs structured by dietary preferences, providing nutritional information and ingredients in its products. This action was in harmony with one of the reasons that lead its customers to prefer to buy at WFM (namely, the customers' care about their health and their specific demands). On the other hand, Amazon continued to show its concerns about the offer of a fast delivery service at competitive prices. Accompanied by the announcement of the third round of price cuts in the first quarter of the year, it was speculated that Amazon was looking for new ways to expand its reach. In fact, at the beginning of 2019, it was speculated that Amazon could be preparing an acquisition of other company with a significant physical presence, in order to be closer to its users<sup>157</sup>. Lastly, in order to incentive value maximizing actions, it was also advanced that, starting on the first half of 2019, WFM would bring back its employee stock option programs to all its employees with at least 6000 service-hours (which were extinguished at the moment of the acquisition).

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<sup>157</sup> Namely, the acquisition of Sears, the fifth larger American department store chain, at the time.

## 5. Discussion

According to the neoclassical merger theory, mergers are a mean (short-cut) by which the managers, in response to regime shifts, can pursue value-maximizing operations<sup>158</sup>. In our opinion, the acquisition that we propose here to analyze perfectly fits into this perception. At first glance, food industry may appear to have little opportunities to grow. However, if we consider the complementarity between in-store and online grocery sales it is possible to identify a key opportunity for traditional hard discount grocery chains to grow. Furthermore, in the recent past in the U.S., it is perceptible a profound change in consumers' preferences (mainly driven by millennials). Alongside with evidences of a fast growth on online grocery orders, an increasing portion of American consumers are shifting their preferences towards healthier, environment-friendly products.

One logical question that arises from analyzing this acquisition is if online retail will fully replace in-store retail, and consequently, if Amazon's entrance into the "offline" groceries retail was an astute move. In the past, Amazon demonstrated its capability of disrupting the space when it enters in a business, converting whatever exists in it obsolete. However, in our opinion, this notion does not apply to the acquisition that we propose here to analyze. Despite the several potential changes that Amazon could implement at WFM's stores (such as certain automated processes, or the expansion of WFM's distribution channels), it is clear that the online giant does not intend to make in-store sales obsolete. One of company's major hurdles in the present is to get consumers that favor in-store experience to decide what they want to buy (i.e. consumers that desire the see/touch the products that they are considering to buy, favor personal contact in order to get a feedback

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<sup>158</sup> See Mitchell and Mulherin (1996) and Jovanovic and Rousseau (2001).

concerning the products, among other aspects)<sup>159</sup> to buy and/or sign to its services. Besides, we have to remind that today, the majority of consumers still favor physical stores. In this sense, the deal would enable Amazon to gain from the complementarity between online and offline retail, allowing the company not only to expand its distribution channels and customer base, but also to develop new capabilities (an important part of Amazon's strategy)<sup>160</sup>.

Furthermore, by analyzing other retailers' performance, it is also possible to conclude that, at least in the near future, the "offline" retail will not disappear, at the expense of online retail. Some "traditional" grocery chains, such as ALDI and Lidl, have been shown evidences of improvement in terms of performance and continuous growth (especially in the U.S.). On the other hand, by looking at WFM's competitors, it is also possible to find support for the idea of complementarity between online and offline sales. Even though Amazon's acquisition did not initiate an industry merger wave<sup>161</sup>, it gives additional support (rationally) for some of its investors' investment decisions. As referred above, its competitors in the food industry are strongly committed to expand their online presence<sup>162</sup>, without divesting in their "traditional" segments. Relying on these factors, the logical conclusion is that one-channel strategy is not sustainable anymore. Considering the change in the patterns of demand, today, in order to position themselves as a competitive firm in the food industry, as well as in the vast majority of sectors, "traditional" grocery chains need to conjugate its offerings with a strong online

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<sup>159</sup> As it was previously said, this applies specially to WFM's "average" client, whom is expected to be proponent of going to the actual store and choose the specific products that they will buy.

<sup>160</sup> Amazon's recent moves clearly show us the benefits of considering online and offline segments as complementary, rather than competitive ones.

<sup>161</sup> Defined as a period of time characterized by a significant number of mergers, simultaneously, within an industry. In our case, the rational that could have supported an industry merger wave would be the change in the pattern of demand. Yet, following Martynova and Renneboog (2008), and Harford (2004), an industry shock per se does not support a merger wave.

<sup>162</sup> An opposite movement from the one embedded on Amazon's decision to acquire WFM.

presence. Conversely, we highlight the fact that, while Amazon has a competitive advantage in online services, due to its expertise and reach, the company still has a reduced number of physical stores. On this matter, WFM's stores could serve as a "test" for Amazon (i.e. this acquisition could be only the company's first experience, on a big scale, with "offline" retail), from which the company can develop new ways of selling its products, and better understand consumers' "offline" behavior<sup>163</sup>.

Similarly, if we consider Amazon's plans to expand its presence not only within the segments in which it is already operating, but also to new ones, it becomes clear the fit of the acquisition in the company's strategy. As we affirmed previously, one of the rationales that supported Amazon's decision to acquire WFM was the acceleration of the entrance into the organic-food industry<sup>164</sup>, however, this deal does not limit itself to groceries retail. From our perspective, together with the deal's conglomerate features (given the involvement of two companies that operate in unrelated lines of business), it is also clear Amazon's ultimate goal of a vertical supply chain integration of this acquisition towards the final consumer (perfectly reflecting Amazon's long-term vision of controlling its delivery chain). WFM's stores are functioning as "small" warehouses for Amazon's products, located near several population centers across the U.S. However, these do not have the size desired by Amazon to fulfil its goals<sup>165</sup>. We expect that, in the future, Amazon will continue to acquire other companies with a strong physical presence (or grow organically), in order to reinforce its distribution channels. This way, Amazon could

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<sup>163</sup> Furthermore, with the introduction of its products into WFM's stores, Amazon could also benefit from customers' feedback on its products and from building relationships with its customers.

<sup>164</sup> Allowing Amazon to add a new set of private brands to its portfolio – diversification.

<sup>165</sup> We have to remember that, despite the fact that the acquisition gave Amazon instant access to more than 460 stores located strategically throughout the U.S., and WFM's plans to open 93 new stores in existing trade areas as well as new areas, including international locations, its presence in the food industry continued to be residual, in relative terms. As it was affirmed before, one of the online giant next steps is to assume control of the last-mile of distribution. Plus, the company is also strongly committed in providing a fast-delivery service of its products (which requires to be located near population centers).

either: apply a similar strategy to the one applied into WFM's stores, adding its products, and providing a click-and-collect service; or ultimately convert its acquired physical stores into ones that exclusively sell Amazon's products/services<sup>166</sup>.

Nonetheless, it is also possible to identify a set of problems concerning the acquisition/integration of WFM. First, we highlight the clash of culture between the two companies. As it was previously referred, WFM's distinctive culture was one of the factors that allowed them to attract a loyal base of customers (source of value-creation). Despite Amazon's efforts to adopt the best part of each culture, the general perception was that the deal would distance WFM from its roots. In reality, many labeled it as the "*conventionalization of WFM*". To support this idea, many underlined the fact that, after the acquisition, all the buying decisions related to in-store offerings became centralized, and a new set of "common brands" names started to emerge on WFM's shelves<sup>167</sup>. This way, WFM's regional teams lost their autonomy to source local products, and many of its loyal customers started to feel the loss of "neighbor" emotionalism when shopping at WFM.

Second, Amazon was struggling in gaining the trust of some stakeholders. In more detail, we highlight WFM's employees lack of trust on Amazon's statements concerning their jobs security, which could lower their expectations for future and difficult their retention (some resistance to the process of integration). The truth is that Amazon's tests concerning cashierless-technologies were signaling a contradictory message to its statements denying future massive layoffs. On the other hand, WFM's prior and new usual customers were doubting Amazon's capability of

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<sup>166</sup> Following Amazon's financial statements, the online giant was able to increase its number of physical stores from 472 to 527 (an increase of 11.7%), from 2017 to 2018.

<sup>167</sup> Following Brittain Ladd, a former Amazon's retail consultant: "Amazon is performing a lot of analysis to identify what products to put on their shelves to bring the most customers, not to retain current customers".

lowering WFM's products prices. To this regard, we consider that the press set excessively high expectations (over-extrapolated Amazon's past performance). The truth is that Amazon is still learning, and it is predictable that the company continues to make efforts to gradually lower WFM's prices (making its products affordable to everyone), luring more customers and, subsequently, increase its market share.

Lastly, according to some reports from WFM's usual customers, Amazon was struggling in managing, in some WFM's stores, its in-store stocks. Due to the significant increase of online groceries orders, part of WFM's products were being directly send to the consumer, instead of being put on the shelves, generating some discontent among WFM's prior loyal customers (despite the positive side of this problem, this would increase Amazon's challenge to retain these customers).

Many analysts shared the idea that if the acquisition would not have occurred, the most probable scenario would be the aggravation of the WFM' financials as well as the brand itself. However, one might question how Amazon was perceived by WFM. During the pre-acquisition phase, the company also had alternative proposals, not only from another companies, but also from private equity funds. The logical conclusion is that Amazon's value-proposition was superior to those from its competitors. As a matter of fact, it is possible to highlight a set of factors that could have differentiate Amazon from its competitor bidders, namely: (1) Amazon's purchasing power would be a powerful tool to accomplish WFM's commitment of lowering its prices; (2) Amazon's deep pockets would provide the capital required to engage certain long-term initiatives/investments; (3) Amazon already possessed the infrastructure required to expand WFM's delivery services (as well as to add other complementary services), enabling them to take advantage from this fast-growing segment in the U.S.; (4) Amazon's customers base and expertise

could be an important factor both to lure more customers to WFM's stores, and to lead them to buy more, i.e. by applying a similar approach to the one applied to its online retail, Amazon could develop new capabilities to use data from past buys at WFM's stores to offer the best suggestions and/or discounts that would maximize its existing and "new" customers in-store affluence, and maximize their consumption.

From the data presented in previous sections, it is perceived a strong market reaction to the announcement of the acquisition. Investors anticipated significant wealth-increases (synergies) from the merger between Amazon and WFM<sup>168</sup>. In our opinion, and considering Amazon's innovations/investments in WFM initiated after the conclusion of the deal, we have reasons to believe that the market was efficient. Together with the fact that WFM was operating below its potential, the acquisition would give Amazon new growth opportunities, not only through its tangible assets (i.e. its physical stores, necessary to expand Amazon's distribution channels), but also through its intangible assets (i.e. its expertise)<sup>169</sup>.

To conclude we highlight that, with the aim of creating shareholder value, a company should effectively balance short-term performance against investment decisions that would generate long-term cash-flows/growth<sup>170</sup>. In this sense, in many M&A deals value can take time to unfold. Thus, an important question that we also

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<sup>168</sup> In our case, the deal's synergies can be attributed mainly to "operating synergies". However, in order for the anticipated synergies to have an effective impact on Amazon' value, it must generate: higher expected growth rates; longer competitive advantage period; higher cash-flows from existing assets; or lower costs of capital.

<sup>169</sup> Despite the fact that synergies valuation was not our focus, we can postulate that part of the premium paid to acquire WFM includes a "capabilities premium". In fact, in M&A today, there are evidences of an increasing market for capabilities.

<sup>170</sup> Alternatively, it is possible to identify some gains for WFM's bondholders after the acquisition. After the acquisition, Amazon conducted an exchange offer related to the \$1 bn. 5.2% senior notes due 2025 assumed in the acquisition of WFM, leading to an upgraded on WFM's notes credit rating to Baa1 (Moody's). According to Billett (2004) "target bonds have significantly larger returns when the target's rating is below the acquirer's" (which occurred in our case). Also, when two companies possess imperfectly correlated cash-flows, they are able to reduce their systematic risk, due to the avoidance of counter cyclical dead weight costs (coinsurance).

need to answer is when it is expected that the synergies start to affect Amazon's cash-flows. From our perspective, the acquisition of WFM clearly represents a long-term move by Amazon, i.e. supports its long-term vision of becoming the "only" company, allowing it to expand its geographic reach and its basket of products and services. Still, we also anticipate an immediate impact of the deal's synergies on Amazon's cash-flows. To this extent, one of our limitations relies on the fact that, after the acquisition, we do not have access to detailed information concerning WFM's operations. Plus, in order to correctly assess how the merger with WFM affected Amazon's performance, we would need to know the costs of the implementation of certain innovations at WFM. As a result, with the purpose of supporting our conclusion, we decided to analyze some Amazon's key indicators (from the completion of the deal until the present)<sup>171</sup>:

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<sup>171</sup> See also *Annex – 10. Amazon's Key Indicators*.

	Industry Median	Q3- 2017	Q4- 2017	Q1- 2018	Q2- 2018	Q3- 2018	Q4- 2018	Q1- 2019
Gross Profit Margin <i>1Y Growth</i>	30.6%	37.0% 2.0%	36.3% 2.5%	39.8% 2.6%	42.1% 3.9%	41.7% 4.7%	38.1% 1.8%	43.2% 3.4%
EBITDA Margin <i>1Y Growth</i>	13.3%	7.5% (0.6%)	9.3% 1.2%	11.0% 1.4%	12.5% 3.9%	13.3% 5.8%	11.1% 1.8%	15.5% 4.5%
Operating Margin <i>1Y Growth</i>	8.5%	0.8% (1.0%)	3.5% 0.6%	3.8% 1.0%	5.6% 3.9%	6.6% 5.8%	5.2% 1.7%	7.4% 3.6%
Pretax Margin <i>1Y Growth</i>	5.6%	0.7% (0.8%)	3.1% 0.4%	3.8% 1.1%	4.9% 3.1%	6.0% 5.3%	4.6% 1.5%	7.4% 3.6%
Effective Tax Rate <i>1Y Growth</i>	22.7%	18.4% (28.2%)	42.9% 7.5%	15.0% (9.0%)	2.8% (67.3%)	15.0% (3.4%)	14.4% (28.5%)	19.0% 4.0%
Net Margin <i>1Y Growth</i>	4.6%	0.6% (0.2%)	1.8% 0.1%	3.2% 1.2%	4.8% 4.3%	5.1% 4.5%	4.0% 2.2%	6.0% 2.8%
Asset Turnover <i>1Y Growth</i>	0.25	0.43 (10.5%)	0.49 (13.5%)	0.40 (8.8%)	0.41 (9.7%)	0.41 (5.5%)	0.47 (3.6%)	0.35 (11.6%)
Pretax ROA <i>1Y Growth</i>	1.2%	0.3% (0.4%)	1.5% 0.0%	1.5% 0.3%	2.0% 1.2%	2.4% 2.1%	2.2% 0.7%	2.6% 1.1%
Pretax ROE <i>1Y Growth</i>	2.2%	1.3% (1.6%)	7.1% 0.8%	6.5% 1.8%	7.8% 4.8%	9.1% 7.8%	8.1% 1.0%	9.6% 3.1%
x Tax Complement <i>1Y Growth</i>	0.79	0.81 57.8%	0.99 54.5%	0.85 11.9%	0.97 >99%	0.85 5.0%	0.90 (9.0%)	0.81 (4.8%)
ROE <i>1Y Growth</i>	1.8%	1.1% (0.4%)	4.1% 0.1%	5.5% 2.0%	7.6% 6.7%	7.8% 6.7%	6.9% 2.8%	7.7% 2.2%
x Earnings Retention <i>1Y Growth</i>	0.67	1.00 0.0%	1.00 0.0%	1.00 0.0%	1.00 0.0%	1.00 0.0%	1.00 0.0%	1.00 0.0%
Reinvestment Rate <i>1Y Growth</i>	1.6%	1.1% (0.4%)	4.1% 0.1%	5.5% 2.0%	7.6% 6.7%	7.8% 6.7%	6.9% 2.8%	7.7% 2.2%
ROIC <i>1Y Growth</i>	-	0.4% (0.3%)	1.5% (0.5%)	2.1% 0.4%	3.1% 2.7%	3.4% 3.0%	3.1% 1.6%	3.4% 1.3%
Cash Cycle (Days) <i>1Y Growth</i>	46.7	(17.5) (27.3%)	(18.7) 1.5%	(21.8) 12.5%	(14.7) 13.1%	(16.8) 3.7%	(17.2) 8.1%	(23.9) (9.7%)
Assets/Equity <i>1Y Growth</i>	2.18	4.67 17.2%	4.74 9.6%	4.02 7.5%	3.83 1.3%	3.67 (21.2%)	3.73 (21.2%)	3.68 (8.4%)
Debt/Equity <i>1Y Growth</i>	0.64	1.75 64.4%	1.59 50.5%	1.41 41.9%	1.31 28.6%	1.21 (31.1%)	1.13 (29.0%)	0.51 (63.9%)
% LT Debt to Total Capital <i>1Y Growth</i>	31.4%	54.0% 12.9%	52.8% 14.5%	50.0% 13.0%	48.1% 10.8%	46.2% (7.8%)	42.9% (9.9%)	31.9% (18.1%)
(Total Debt- Cash)/EBITDA <i>1Y Growth</i>	12.96	3.23 >99%	2.85 -	2.92 -	2.89 >99%	2.41 (25.3%)	1.58 (44.4%)	- -

**Table 5:** Amazon's Post-Acquisition Key Indicators (quarterly).

Source: Thompson Reuters Eikon Database.

Despite the impact of the acquisition on some Amazon's indicators, from the table presented above it is possible to gather some evidences of Amazon's success in the recent past. In comparison to the industry's median, it is possible to conclude that Amazon is considerably outperforming its peers in terms of profitability and earnings power. Since the moment of the acquisition, Amazon perfectly managed to increase its profitability, combining a higher capability of generating greater free cash-flows with higher margins. Moreover, during the same time period, it was also able to deliver increasing levels of return-on-assets, return-of equity, and return-on-invested-capital<sup>172</sup>. In complement, by analyzing the company's financial statements, it is also possible to perceive the significant impact of the acquisition on Amazon's revenue. In the year of 2018, its physical stores were already contributing for 7.4% of the company's total revenue (a superior contribution from the one generated by its subscription services, for example)<sup>173</sup>. Also, as per in its 2018 annual report, its Net Sales in North America increased from \$106,110 million, in 2017, to \$141,366 million, in 2018.

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<sup>172</sup> In this respect, we highlight the fact that, in the beginning of this time window, Amazon's higher levels of ROE were triggered mainly due to its higher leverage and asset turnover. Nevertheless, since the second quarter of 2018, the company also started to deliver higher net margin (in comparison to its peers), factor that also contributed to explain the rationales for Amazon's superior ROE.

<sup>173</sup> See *Annex – 11. Amazon's Segments*.

## 6. Conclusion

The food industry is a large, increasingly competitive one, and in the past few years, we were able to observe a profound change in customers' patterns of demand. In this sense, the merger with WFM allowed Amazon the combination of complementary capabilities and higher growth in new and existing markets. Firstly, we highlight the fact that through the deal Amazon would be able to expand its physical presence. This key factor would enable the company not only to fulfil its long-standing commitment of fast-delivering services (and simultaneously take control of the "last-mile" of distribution), but also to use data from its customers' in-store purchases to develop new ways of selling its products. Secondly, we highlight the fact that the acquisition took place at a moment that allows Amazon to profit from (and/or accelerate) the considerable growth of both online groceries retail, and organic-food retail in the U.S. Even though Amazon's delivery services are not unique (i.e. they can be replicated by a competitor), it is possible to conclude that the company's expertise and reach can truly function as a competitive advantage.

In order to compete with Amazon, other retailers were "obligated" to engage/reinforce their investments in their online segments (an opposite movement to the one implied in Amazon's acquisition of WFM). Additionally, in our opinion, with the end of maintaining their competitiveness, "traditional" grocery retailers are also required to upgrade their technologies, collect more data about its customers, and include an extensive set of unique/private brands in their offering (in order to differentiate themselves).

All factors considered, we argue that the acquisition perfectly fits in Amazon's strategy. The acquisition of WFM allowed Amazon not only to empower its capabilities, but also to expand its ecosystem. However, we defend that this deal

could be just the first step of a long and costly process to Amazon. To achieve its ultimate goal of allying a strong physical presence with its online dominance, for the future we predict that the company will continue to acquire companies with complementary resources (and/or grow organically), in new or pre-established segments.

To conclude, we also recognize some gaps in our analysis that may be subject to further research. First, we suggest a profound quantitative approach of the acquisition, assessing the value of both companies at the time of the deal, and how the premium is divided between the value of the potential synergies and the value of control (enabling us, for example, to evaluate how the gains were distributed among the involved parts, or to infer if Amazon's offer embeds, in fact, a fair price per WFM's share). Second, a complementary analysis that could add interesting conclusions to our study would be the evaluation of the implications of the deal for other stakeholders, such as WFM's bondholders, employees, and suppliers. Similarly, as referred above, in order to have a clear picture of deal's value-creation, one should also analyze competitors' reactions to the deal, assessing the investments made by WFM's competitors as a response to Amazon's entrance in the food industry. Third, we also propose the evaluation of Amazon's active M&A strategy on its performance/returns in the past years (assessing if Amazon's strategy is indeed a profitable one, and if Amazon's stock price embeds any premium related to its success in M&A).

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# Appendix

## 1. Summary of the acquisition's key aspects

<b>Parties</b>	Amazon.com, Inc.; Whole Foods Market, Inc.; Walnut Merger Sub, Inc.
<b>Motives</b>	Fast entrance in the organic food industry; Expand Amazon's distribution channels; Learning about customers' "offline" behavior.
<b>Market's reactions</b>	At the announcement, on June 16 <sup>th</sup> , 2017, Amazon's and Whole Foods Market's stock price went up by approximately 25.54% and 2.41%, respectively (compared to their stock prices one day prior to the announcement). On the other hand, Whole Foods Market's competitors, such as Walmart, Target and Sprouts Farmers experienced negative returns during the same time window (-4.76%, -5.28%, and -6.50%, respectively). Additionally, considering the time window from 10 trading-days prior to the announcement of the acquisition to 10 trading-days after its announcement, the acquisition generated a cumulative-abnormal-return of 18.85% and 0.42% to Whole Foods Market and Amazon, respectively.
<b>Financing</b>	To finance the acquisition, Amazon entered into a commitment letter with Goldman Sachs Bank USA, Goldman Sachs Lending Partners LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and Bank of America, N.A., in order to obtain a 364-day senior unsecured bridge term loan, summing a principal amount of \$13.7 bn. Next, to fulfill its responsibilities towards the initial financing, Amazon choose to sell debt, totaling \$16 bn. across 7 tranches.
<b>Payment method</b>	Amazon opted for paying entirely with cash.
<b>Offer</b>	\$42 per Whole Foods Market's share, which implied a premium equal to 17.61% (when compared to WFM's stock price at the first contact between the two companies), and an estimated total consideration of \$13,571,748,138 (\$14,755,452,138, including Amazon's total fee and Whole Foods Market's long-term debt).
<b>Fees</b>	Whole Foods Market paid a total fee equal to \$45 million, while Amazon paid a total fee equal to \$25.704 million (0.33% and 0.19%, respectively, when compared to the total consideration).
<b>Merger</b>	Whole Foods Market was incorporated into Amazon through a reverse triangular merger. The organic food chain merged with Walnut Merger Sub (the special-purpose-vehicle) and continued to exist. As a result of this operation, WFM became a subsidiary to Amazon. Additionally, Whole Foods Market was delisted from NASDAQ and deregistered under the Exchange Act.

Table A.1: Summary of the acquisition's key aspects.

## 2. Companies' historical stock prices



**Graph A.1:** Whole Foods Market's historical stock prices, from April 2017 to the conclusion of the deal.

Source: Thompson Reuters Eikon Database



**Graph A.2:** Amazon's historical stock prices, from April 2017 to the conclusion of the deal.

Source: Thompson Reuters Eikon Database

### 3. Multiples Valuation of Whole Foods Market

In order to enable us to assess the fairness of Amazon's offer, we conducted a multiple valuation of Whole Foods Market's enterprise value and price per share on the closest moment (depending on the available data) preceding the announcement of the deal. Following DePamphilis (2015), multiple valuation "involves valuing assets based on how similar assets are valued in the marketplace. Such methods assume a firm's market value can be approximated by a value indicator for comparable companies, comparable transactions, or comparable industry averages." In addition, following Liu et al. (2002), "multiple approach relies on the same principles underlying the more comprehensive approach: value is an increasing function of future payoffs". As main advantages of this methodology we point out its simplicity (not only to compute, but also to be interpreted) when compared to discounted cash-flows methods, and the fact that it is more likely to reflect the current market conditions.

Based on the vast literature about multiple valuation (see Koller et al. (2010), and Damodaran (2002)), we decided to evaluate Whole Foods Market's enterprise value and stock price based on four multiples, namely:

- *Enterprise Value Multiples*: Enterprise Value / 12 Months Forward EBITDA and Enterprise Value / 12 Months Forward Sales;
- *Equity Multiples*: Dividend-Yield and Price-to-Book Value of Equity.

$$EV/12M\ FWD\ EBITDA = \frac{Current\ Enterprise\ Value}{12\ Months\ Forward\ EBITDA};$$

$$EV/12M\ FWD\ Sales = \frac{Current\ Enterprise\ Value}{12\ Months\ Forward\ Sales};$$

$$\text{Dividend Yield} = \frac{\text{Annual Dividend per share}}{\text{Share Price}};$$

$$\text{Price to Book Value of Equity} = \frac{\text{Market Value of Equity per share}}{\text{Book Value of Equity per share}}.$$

Based on Liu et al. (2002; 2007) and Koller et al. (2010), we opted to include forward-looking multiples in our analysis. As per the work developed by the authors, multiples valuations derived from these measures tend to outperform (i.e. are more accurate) those derived from historical measures.

In the group of peers we decided to include not only grocery chains that focus mainly on organic products, but also some mass retailers. Concretely, we selected the following peers: Walmart, Inc.; Kroger, Co; Target, Corp.; Costco Wholesale, Corp.; Sprouts Farmers Market, Inc.; and Ingles Markets, Inc.

Resorting to Thompson Reuters Eikon Database, we collected the following data concerning the multiples of Whole Foods Markets' peers:

	EV / 12M FWD EBITDA	EV / 12M FWD Sales	Dividend- Yield (%)	Price-to-Book Value of Equity
Walmart	8.432	0.556	2.58	2.99
Kroger	6.946	0.351	1.59	3.79
Target	6.05	0.563	4.39	2.53
Costco	14.244	0.608	1.1	7.36
Sprout Farmers	11.607	0.785	0	4.92
Ingles	6.572	0.402	1.84	1.42
<b>Average<sup>1</sup></b>	<b>8.975</b>	<b>0.544</b>	<b>1.917</b>	<b>3.835</b>

**Table A.2:** Peer's group multiples.

Source: Thompson Reuters Eikon Database (data from June 8<sup>th</sup>, 2017).

<sup>1</sup> Approximated values.

Also, resorting to Thompson Reuters Eikon Database, we also collected the following data related to Whole Foods Market:

- 12M FWD EBITDA: \$1,310,433;
- 12 FWD Sales: \$16.289.050;
- Annual Dividend per share: \$0.72;
- Book Value of Equity per share: \$10.80625.

Lastly, using the information provided above and peer's average for each multiple, we were able to compute Whole Foods Market's implied enterprise value and share price on June 8<sup>th</sup>, 2017.

#### 4. Cumulative-Abnormal>Returns (CARs)

Despite the fact that our approach differs from an “event study methodology”, in order to deepen our understanding about the impacts of the acquisition on both companies’ returns, we compute (using data from the Thompson Reuters Eikon Database) the cumulative-abnormal-returns (CARs) for the periods: (1) from T-10 to T+10; and (2) from T-49 to T+10 (T=0 represents the date in which the deal was announced). The first time window will give us a closer look on the impact of the announcement of the acquisition. The second will give us useful insights concerning the impacts on both companies’ returns from the moment in which Whole Foods Markets demonstrated interest in being acquired, enabling us to understand if there are any sings of anticipation, by the market, concerning a potential restructuring operation. The general idea is to try to isolate the impact of the acquisition from other general market movements during the period in consideration.

The first step to compute a company’s Abnormal Returns ( $AR_{i,T}$ ), defined as the difference between the Actual Returns ( $R_{i,T}$ ) and the Expected Returns ( $E[R_{i,T}]$ ), is to compute the Actual Returns for both companies we used the following formula:

$$R_{i,T} = \ln \left( \frac{P_{i,T}}{P_{i,T-1}} \right),$$

where  $R_{i,T}$  denotes the daily stock return of company  $i$ , on day  $T$ ; and  $P_{i,T}$  denotes the stock price of company  $i$ , on day  $T$ .

Then, to compute the Expected Returns, and assuming a constant and linear relation between a company’s stock returns and the returns of a market index, we used the following formula:

$$E[R_{i,T}] = \alpha_i + \beta_i * R_{M,T},$$

where  $E[R_{i,T}]$  denotes the expected daily stock return of company  $i$ 's, on day  $T$ ;  $\alpha_i$  denotes the intercept;  $\beta_i$  denotes the slope; and  $R_{M,T}$  denotes the daily stock return from NASDAQ 100 Index, on day  $T$ .

With the results obtained, we next computed the CARs using:

$$CAR_{(t1,t2)} = \sum_{T=t1}^{t2} AR_{i,T},$$

where  $CAR_{(t1,t2)}$  denotes the cumulative abnormal return for the time period between  $t1$  and  $t2$ ; and  $AR_{i,T}$  denotes the daily abnormal stock return of company  $i$ , on day  $T$ .

Also, Amazon's average abnormal return for the next 20 trading-days after the announcement ("average supernormal return") equals 0.088%. However, following Bruner (2004), "M&A event returns must be annualized to compare them to other rates of return that investors experience". Therefore, considering that the NASDAQ 100 Index has 253 trading-days each year, the Amazon's "average supernormal return" corresponds (theoretically) to a return of 24.92%, in annual terms.

# Annex

## 1. Whole Foods Market's and Amazon's financial statements

	2015	2016	2017
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Revenue	15,389	15,724	16,030
Net Sales	15,389	15,724	16,030
Other Revenue, Total	-	-	-
<b>Total Revenue</b>	<b>15,389</b>	<b>15,724</b>	<b>16,030</b>
<b>Cost of Revenue, Total</b>	<b>9,973</b>	<b>10,313</b>	<b>10,633</b>
<b>Gross Profit</b>	<b>5,416</b>	<b>5,411</b>	<b>5,397</b>
Selling/General/Admin. Expenses, Total	4,539	4,541	4,687
Selling/General/Admin. Expenses	4,477	4,494	4,654
Labor & Related Expense	62	47	33
Research & Development	-	-	-
Depreciation/Amortization	-	-	-
Unusual Expense (Income)	16	13	251
Other Operating Expenses, Total	-	-	-
<b>Total Operating Expense</b>	<b>14,528</b>	<b>14,867</b>	<b>15,571</b>
<b>Operating Income</b>	<b>861</b>	<b>857</b>	<b>459</b>
Interest Inc. (Exp), Net-Non-Op., Total	17	(30)	(42)
Interest Expense, Net Non-Operating	-	(41)	(49)
Interest Income – Non-Operating	-	-	-
Investment Income – Non-Operating	17	11	7
Other Non-Operating Income (Expense)	-	-	-
<b>Net Income Before Taxes</b>	<b>878</b>	<b>827</b>	<b>417</b>
Provision for Income Taxes	342	320	172
<b>Net Income After Taxes</b>	<b>536</b>	<b>507</b>	<b>245</b>
Equity in Affiliates	-	-	-
<b>Net Income Before Extra. Items</b>	<b>536</b>	<b>507</b>	<b>245</b>
Total Extraordinary Items	-	-	-
<b>Net Income</b>	<b>536</b>	<b>507</b>	<b>245</b>

**Table B.1:** Whole Foods Market's Income Statement (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	2015	2016	2017	2018
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Revenue	107,006	135,987	177,866	232,887
Net Sales	107,006	135,987	177,866	232,887
Other Revenue, Total	-	-	-	-
<b>Total Revenue</b>	<b>107,006</b>	<b>135,987</b>	<b>177,866</b>	<b>232,887</b>
<b>Cost of Revenue, Total</b>	<b>71,651</b>	<b>88,265</b>	<b>111,934</b>	<b>139,156</b>
<b>Gross Profit</b>	<b>35,355</b>	<b>47,722</b>	<b>65,932</b>	<b>93,731</b>
Selling/General/Admin. Expenses, Total	20,411	27,284	38,992	52,177
Selling/General/Admin. Expenses	19,516	25,989	37,129	49,720
Labor & Related Expense	895	1,295	1,863	2,457
Research & Development	12,540	16,085	22,620	28,837
Depreciation/Amortization	1,381	1,716	2,678	-
Unusual Expense (Income)	-	-	-	-
Other Operating Expenses, Total	(1,210)	(1,549)	(2,464)	296
<b>Total Operating Expense</b>	<b>104,773</b>	<b>131,801</b>	<b>173,760</b>	<b>220,466</b>
<b>Operating Income</b>	<b>2,233</b>	<b>4,186</b>	<b>4,106</b>	<b>12,421</b>
Interest Inc. (Exp), Net-Non-Op., Total	(680)	(371)	(406)	(977)
Interest Expense, Net Non-Operating	(459)	(484)	(848)	(1,417)
Interest Income – Non-Operating	50	100	202	440
Investment Income – Non-Operating	(271)	13	240	-
Other Non-Operating Income (Expense)	15	77	106	(183)
<b>Net Income Before Taxes</b>	<b>1,568</b>	<b>3,892</b>	<b>3,806</b>	<b>11,261</b>
Provision for Income Taxes	950	1,425	1,558	1,354
<b>Net Income After Taxes</b>	<b>618</b>	<b>2,467</b>	<b>2,248</b>	<b>9,907</b>
Equity in Affiliates	(22)	(96)	(4)	9
<b>Net Income Before Extra. Items</b>	<b>596</b>	<b>2,371</b>	<b>2,244</b>	<b>9,916</b>
Total Extraordinary Items	-	-	789	157
<b>Net Income</b>	<b>596</b>	<b>2,371</b>	<b>3,033</b>	<b>10,073</b>

**Table B.2:** Amazon's Income Statement (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Cash and Short Term Investments	392	730	826
Cash & Equivalents	237	351	322
Short Term Investments	155	379	504
Total Receivables, Net	218	242	366
Accounts Receivable – Trade, Net	218	242	242
Receivables – Other	-	-	124
Total Inventory	500	517	417
Prepaid Expenses	108	167	143
Other Current Assets, Total	326	319	339
<b>Total Current Assets</b>	<b>1,544</b>	<b>1,975</b>	<b>2,145</b>
Property/Plant/Equipment, Total, Net	3,163	3,442	3,514
Property/Plant/Equipment, Total, Gross	5,854	6,414	6,797
Accumulated Depreciation	(2,691)	(2,972)	(3,283)
Goodwill, Net	710	710	710
Intangibles, Net	79	74	68
Intangibles – Gross	129	129	126
Accumulated Intangible Amortization	(50)	(55)	(58)
Long Term Investments	63	0	121
Other Long Term Assets, Total	182	140	118
<b>Total Assets</b>	<b>5,741</b>	<b>6,341</b>	<b>6,676</b>

**Table B.3:** Whole Foods Market's Total Assets (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Accounts Payable	295	307	371
Accrued Expenses	436	407	397
Current Port. Of LT Debt/Capital Leases	3	3	2
Other Current Liabilities, Total	518	624	585
<b>Total Current Liabilities</b>	<b>1,252</b>	<b>1,341</b>	<b>1,355</b>
Total Long Term Debt	62	1,048	1,081
Long Term Debt	62	1,048	1,081
Capital Lease Obligations	-	-	-
Deferred Income Tax	-	-	-
Other Liabilities, Total	658	728	810
<b>Total Liabilities</b>	<b>1,972</b>	<b>3,117</b>	<b>3,246</b>
Common Stock, Total	2,904	2,933	2,972
Additional Paid-In Capital	-	-	-
Retained Earnings (Accumulated Deficit)	2,017	2,349	496
Treasury Stock – Common	(1,124)	(2,026)	0
Unrealized Gain (Loss)	-	-	-
Other Equity, Total	(28)	(32)	(38)
Translation Adjustment	-	-	-
Other Comprehensive Income	(28)	(32)	(38)
<b>Total Equity</b>	<b>3,769</b>	<b>3,224</b>	<b>3,430</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>5,741</b>	<b>6,341</b>	<b>6,676</b>

**Table B.4:** Whole Foods Market's Total Liabilities & Shareholders' Equity (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Cash and Short Term Investments	19,808	25,981	30,986	41,250
Cash & Equivalents	15,890	19,334	20,522	31,750
Short Term Investments	3,918	6,647	10,464	9,500
Total Receivables, Net	5,654	8,339	13,164	16,677
Accounts Receivable – Trade, Net	5,654	8,339	13,164	16,677
Receivables – Other	-	-	-	-
Total Inventory	10,243	11,461	16,047	17,174
Prepaid Expenses	-	-	-	-
Other Current Assets, Total	-	-	-	-
<b>Total Current Assets</b>	<b>35,705</b>	<b>45,781</b>	<b>60,197</b>	<b>75,101</b>
Property/Plant/Equipment, Total, Net	21,838	29,114	48,866	61,797
Property/Plant/Equipment, Total, Gross	30,053	42,441	68,573	95,770
Accumulated Depreciation	(8,215)	(13,327)	(19,707)	(33,973)
Goodwill, Net	3,759	3,784	13,350	14,548
Intangibles, Net	992	854	3,371	4,110
Intangibles – Gross	1,847	1,900	4,422	5,350
Accumulated Intangible Amortization	(855)	(1,046)	(1,051)	(1,240)
Long Term Investments	-	242	415	518
Other Long Term Assets, Total	2,453	3,627	5,111	6,574
<b>Total Assets</b>	<b>64,747</b>	<b>83,402</b>	<b>131,310</b>	<b>162,648</b>

**Table B.5:** Amazon's Total Assets (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	2015	2016	2017	2018
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Accounts Payable	20,397	25,309	34,616	38,192
Accrued Expenses	10,372	8,542	11,949	14,161
Current Port. Of LT Debt/Capital Leases	-	5,197	6,221	9,502
Other Current Liabilities, Total	3,118	4,768	5,097	6,536
<b>Total Current Liabilities</b>	<b>33,887</b>	<b>43,816</b>	<b>57,883</b>	<b>68,391</b>
Total Long Term Debt	14,175	15,213	37,926	39,787
Long Term Debt	8,227	7,694	24,743	23,495
Capital Lease Obligations	5,948	7,519	13,183	16,292
Deferred Income Tax	407	392	990	1,490
Other Liabilities, Total	2,894	4,696	6,802	9,431
<b>Total Liabilities</b>	<b>51,363</b>	<b>64,117</b>	<b>103,601</b>	<b>119,099</b>
Common Stock, Total	5	5	5	5
Additional Paid-In Capital	13,394	17,186	21,389	26,791
Retained Earnings (Accumulated Deficit)	2,545	4,916	8,636	19,625
Treasury Stock – Common	(1,837)	(1,837)	(1,837)	(1,837)
Unrealized Gain (Loss)	(1)	16	(16)	-
Other Equity, Total	(722)	(1,001)	(468)	(1,035)
Translation Adjustment	(722)	(1,001)	(468)	-
Other Comprehensive Income	-	-	-	(1,035)
<b>Total Equity</b>	<b>13,384</b>	<b>19,285</b>	<b>27,709</b>	<b>43,549</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>64,747</b>	<b>83,402</b>	<b>131,310</b>	<b>162,648</b>

**Table B.6:** Amazon's Total Liabilities & Shareholders' Equity (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Net Income	536	507	245
Depreciation	439	498	495
Deferred Taxes	(43)	47	8
Non-Cash Items	156	98	272
Changes in Working Capital	41	(34)	118
Accounts Receivable	(21)	(24)	0
Inventories	(61)	(11)	42
Prepaid Expenses	(9)	(59)	14
Accounts Payable	20	13	63
Accrued Expenses	58	(29)	(10)
Other Liabilities	54	76	9
<b>Cash from Operating Activities</b>	<b>1,129</b>	<b>1,116</b>	<b>1,138</b>

**Table B.7:** Whole Foods Market's Cash from Op. Activities (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Capital Expenditures	(854)	(718)	(646)
Purchase of Fixed Assets	(851)	(716)	(646)
Purchase/Acquisition of Intangibles	3	2	0
Other Investing Cash Flow Items, Total	399	(177)	(260)
Acquisition of Business	4	11	0
Sale of Fixed Assets	-	-	-
Sale/Maturity of Investment	928	431	712
Purchase of Investments	(494)	(593)	(959)
Other Investing Cash Flow	(31)	(4)	(13)
<b>Cash from Investing Activities</b>	<b>(455)</b>	<b>(895)</b>	<b>(906)</b>

**Table B.8:** Whole Foods Market's Cash from Investing Activities (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	2015	2016	2017
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Financing Cash Flow Items	9	4	121
Total Cash Dividends Paid	(184)	(177)	(190)
Issuance (Retirement) of Stock, Net	(447)	(925)	49
Sale/Issuance of Common	66	19	51
Repurchase/Retirement of Common	(513)	(944)	(2)
Common Stock, Net	(447)	(925)	49
Issuance (Retirement) of Debt, Net	-	993	(3)
Long Term Debt Issued	-	1,299	0
Long Term Debt Reduction	-	(306)	(3)
Long Term Debt, Net	-	993	(3)
<b>Cash From Financing Activities</b>	<b>(622)</b>	<b>(113)</b>	<b>(265)</b>

**Table B.9:** Whole Foods Market's Cash from Financing Activities (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	2015	2016	2017
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
<b>Cash from Operating Activities</b>	<b>1,129</b>	<b>1,116</b>	<b>1,138</b>
<b>Cash from Investing Activities</b>	<b>(455)</b>	<b>(895)</b>	<b>(906)</b>
<b>Cash from Financing Activities</b>	<b>(622)</b>	<b>(113)</b>	<b>(265)</b>
Foreign Exchange Effects	(5)	6	6
Net Change in Cash	47	114	(27)
Net Cash – Beginning Balance	190	237	473
Net Cash – Ending Balance	237	351	446
Cash Interest Paid	-	27	52
Cash Taxes Paid	383	377	192
<b>Free Cash Flow</b>	<b>275</b>	<b>398</b>	<b>492</b>

**Table B.10:** Whole Foods Market's Cash Flows (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Net Income	596	2,371	3,033	10,073
Depreciation	6,281	8,116	11,478	15,341
Deferred Taxes	81	(246)	(29)	441
Non-Cash Items	2,524	3,115	4,125	5,911
Changes in Working Capital	2,557	3,847	(242)	(1,043)
Accounts Receivable	(1,755)	(3,436)	(4,780)	(4,615)
Inventories	(2,187)	(1,426)	(3,583)	(1,314)
Prepaid Expenses	-	-	-	-
Accounts Payable	4,294	5,030	7,100	3,263
Accrued Expenses	913	1,724	283	472
Other Liabilities	1,292	1,955	738	1,151
<b>Cash from Operating Activities</b>	<b>12,039</b>	<b>17,203</b>	<b>18,365</b>	<b>30,723</b>

**Table B.11:** Amazon's Cash from Op. Activities (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Capital Expenditures	(5,387)	(7,804)	(11,955)	(13,427)
Purchase of Fixed Assets	(5,387)	(7,804)	(11,955)	(13,427)
Purchase/Acquisition of Intangibles	-	-	-	-
Other Investing Cash Flow Items, Total	(1,063)	(1,712)	(15,129)	1,058
Acquisition of Business	(795)	(116)	(13,972)	(2,186)
Sale of Fixed Assets	798	1,067	1,897	2,104
Sale/Maturity of Investment	3,025	4,577	9,677	8,240
Purchase of Investments	(4,091)	(7,240)	(12,731)	(7,100)
Other Investing Cash Flow	-	-	-	-
<b>Cash from Investing Activities</b>	<b>(6,450)</b>	<b>(9,516)</b>	<b>(27,084)</b>	<b>(12,369)</b>

**Table B.12:** Amazon's Cash from Investing Activities (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	2015	2016	2017	2018
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Financing Cash Flow Items	-	-	-	-
Total Cash Dividends Paid	-	-	-	-
Issuance (Retirement) of Stock, Net	-	-	-	-
Sale/Issuance of Common	-	-	-	-
Repurchase/Retirement of Common	-	-	-	-
Common Stock, Net	-	-	-	-
Issuance (Retirement) of Debt, Net	(3,882)	(3,716)	9,928	(7,686)
Long Term Debt Issued	353	618	16,228	768
Long Term Debt Reduction	(4,235)	(4,334)	(6,300)	(8,454)
Long Term Debt, Net	(3,882)	(3,716)	9,928	(7,686)
<b>Cash From Financing Activities</b>	<b>(3,882)</b>	<b>(3,716)</b>	<b>9,928</b>	<b>(7,686)</b>

**Table B.13:** Amazon's Cash from Financing Activities (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

	2015	2016	2017	2018
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
<b>Cash from Operating Activities</b>	<b>12,039</b>	<b>17,203</b>	<b>18,365</b>	<b>30,723</b>
<b>Cash from Investing Activities</b>	<b>(6,450)</b>	<b>(9,516)</b>	<b>(27,084)</b>	<b>(12,369)</b>
<b>Cash from Financing Activities</b>	<b>(3,882)</b>	<b>(3,716)</b>	<b>9,928</b>	<b>(7,686)</b>
Foreign Exchange Effects	(374)	(212)	713	(351)
Net Change in Cash	1,333	3,759	1,922	10,317
Net Cash – Beginning Balance	14,557	16,175	19,934	21,856
Net Cash – Ending Balance	15,890	19,934	21,856	32,173
Cash Interest Paid	325	290	328	854
Cash Taxes Paid	273	412	957	1,184
<b>Free Cash Flow</b>	<b>6,652</b>	<b>9,399</b>	<b>6,410</b>	<b>17,296</b>

**Table B.14:** Amazon's Cash Flows (\$ Millions).

Source: Thompson Reuters Eikon Database.

Note: The table above contains information from the standardized financial statements as provided from the Thompson Reuters Eikon Database. Additionally, in the same database it was also provided complementary information that allow us to better understand how each line is computed and how the company is performing in additional aspects.

Whole Foods Market's financial results have been included in Amazon's consolidated financial statements from the date of the acquisition (August 28<sup>th</sup>, 2017). The aggregate net sales and operating loss of WFM consolidated into Amazon's financial statements, since the date of acquisition, was \$5.8 bn. and (\$24) million for the year ended December 31, 2017.

Additional Information:

	2015	2016	2017
Period End Date	27-Sep-2015	25-Sep-2016	24-Sep-2017
Comparable Store Sales	2.5%	(2.5%)	(1.5%)
Change in transactions	0.8%	(2.6%)	(2.4%)
Change in basket size	1.7%	0.1%	0.9%
Total Revenue (\$ Million)	15,389	15,724	16,030
Gross Profit / Revenue	35.19%	34.41%	33.67%
Op. Income / Gross Profit	15.90%	15.84%	8.5%
Op. Return on Sales	5.59%	5.45%	2.86%
Net Income Margin	3.48%	3.22%	1.53%
Return on Total Assets	9.33%	8.39%	3.76%
Return on Comm. Equity	14.14%	14.5%	7.36%
Return on Invested Capital	11.9%	10.7%	4.7%
Reinvestment Rate	9.23%	9.52%	2.92%
Diluted Earnings-per-Share (\$)	1.48	1.55	-1

**Table B.15:** Whole Foods Market – Additional Information.

Source: Thompson Reuters Eikon Database.

<sup>1</sup> Diluted Earnings-per-Share 9-months ended: 0.94

	2015	2016	2017	2018
Period End Date	31-Dec-2015	31-Dec-2016	31-Dec-2017	31-Dec-2018
Online Sales (\$ Million)	76,863	91,431	108,354	122,987
Retail Sales (\$ Million)	-	-	5,798	17,224
Total Revenue (\$ Million)	107,006	135,987	177,866	232,887
Gross Profit / Revenue	33.04%	35.09%	37.07%	40.25%
Op. Income / Gross Profit	6.32%	8.77%	6.23%	13.25%
Op. Return on Sales	2.09%	3.08%	2.31%	5.33%
Net Income Margin	0.56%	1.74%	1.71%	4.33%
Return on Total Assets	1.04%	3.33%	2.09%	6.74%
Return on Comm. Equity	4.94%	14.52%	9.55%	27.83%
Return on Invested Capital	2.2%	7.00%	4.00%	11.80%
Reinvestment Rate	4.94%	14.52%	9.55%	27.83%
Diluted Earnings-per-Share (\$)	1.25	4.90	6.15 <sup>1</sup>	20.14

**Table B.16:** Amazon – Additional Information.

Source: Thompson Reuters Eikon Database.

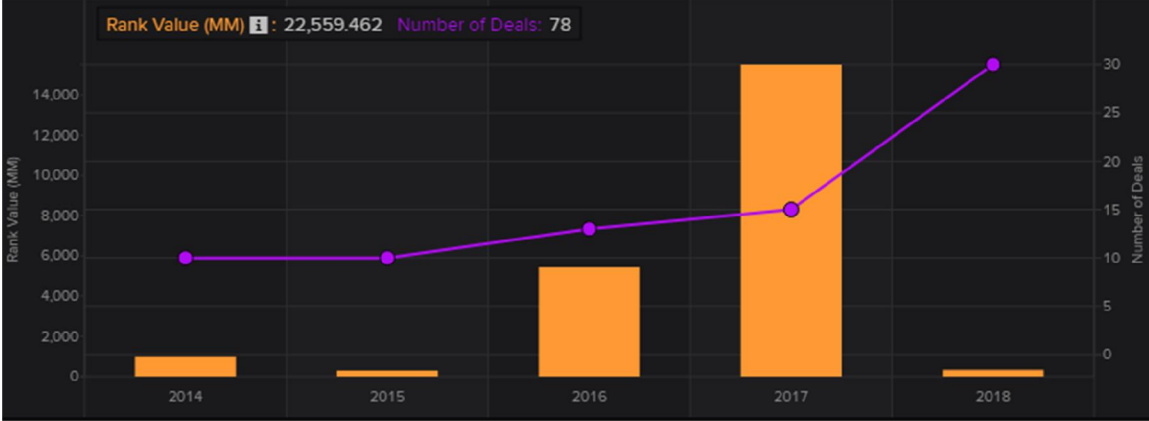
<sup>1</sup> The results of Whole Foods Market have been included in Amazon's results of operation from the date of acquisition.

Further, the acquisition of Whole Foods Market was allocated on Amazon's annual reports as follows (\$, in million):

- *Purchase Price (net of cash acquired):* 13,176;
- *Allocation:*
  - Goodwill: 9,010;
  - Intangible assets: 2,335;
  - Property and equipment: 3,794;
  - Deferred tax assets: 95;
  - Other assets acquired: 1,711;
  - Long-term debt: (1,158);
  - Deferred tax liabilities: (925);
  - Other liabilities assumed: (1686).

Also, according to Amazon's annual report, from 2017, the acquisition's related costs were expensed as incurred.

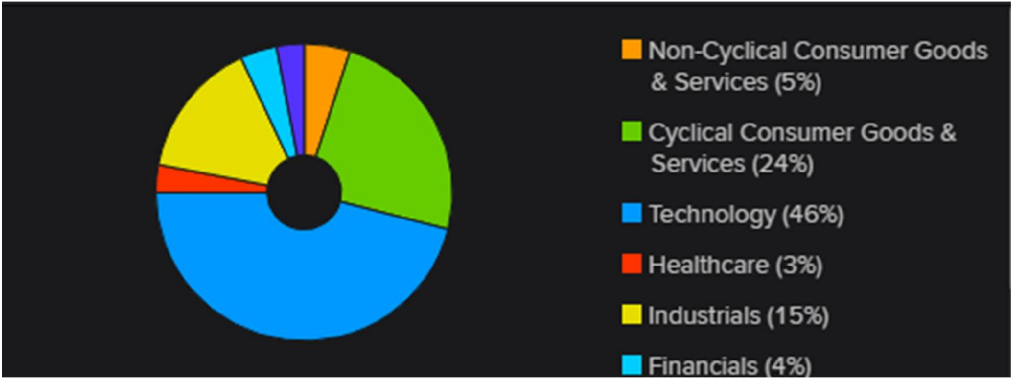
## 2. Amazon's M&A deals



**Graph B.1:** Amazon's M&A deals, from 2014 to 2018.

Source: Thompson Reuters Eikon Database

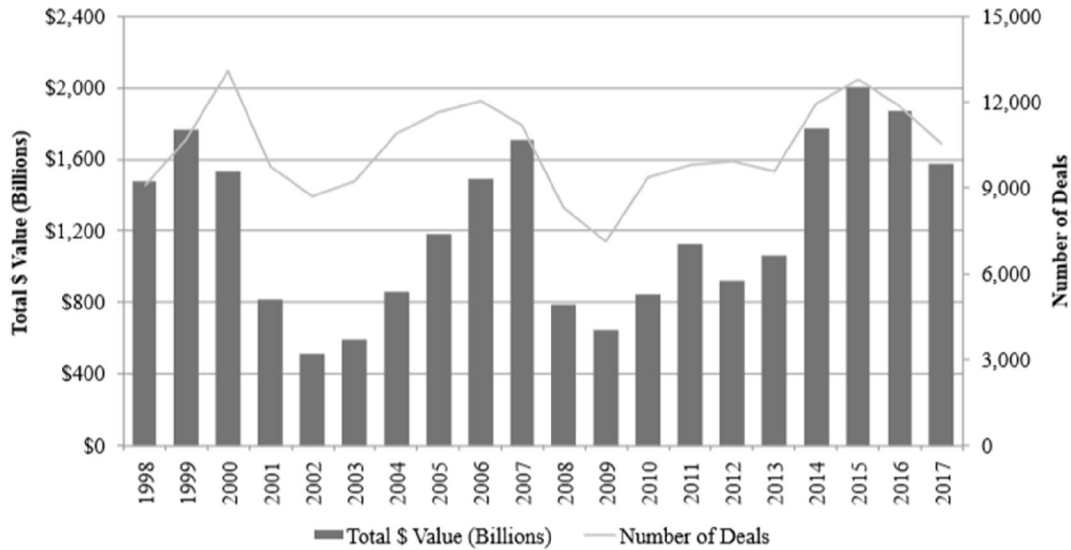
Note: During the same time period, Amazon's average (median) deal size was \$777.912 million (\$27.667 million).



**Graph B.2:** Amazon's number of M&A deals per industry, from 2014 to 2018.

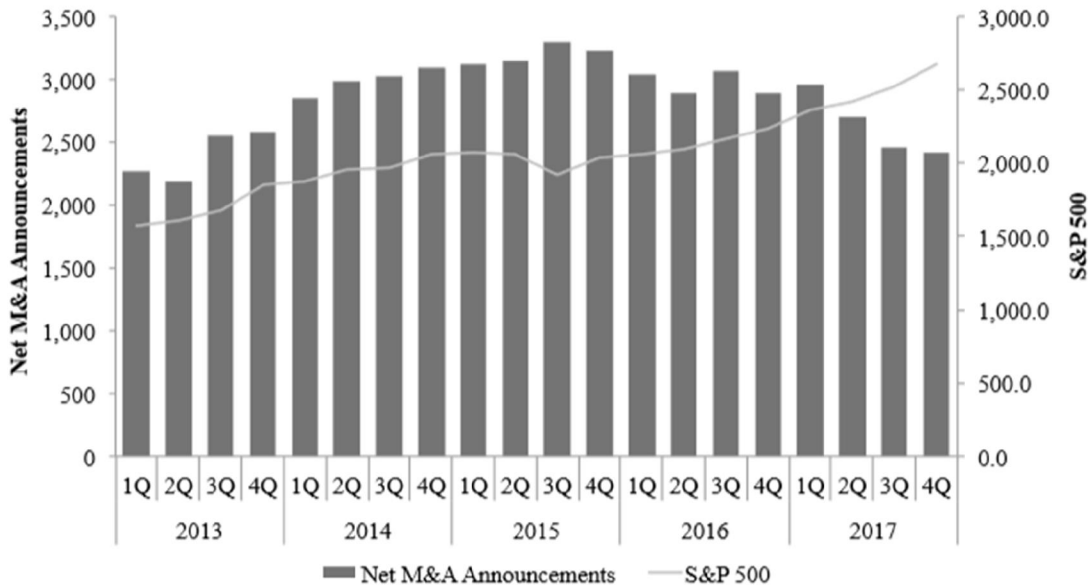
Source: Thompson Reuters Eikon Database

### 3. M&A activity in the recent past



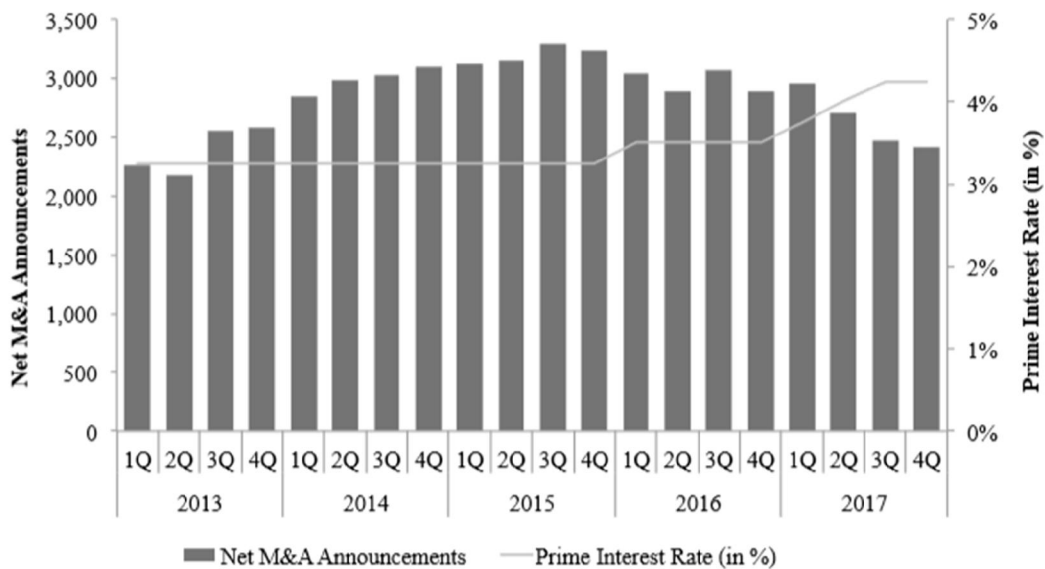
**Graph B.3:** Trends in M&A, from 1998 to 2017.

Source: Mergerstat Review 2018

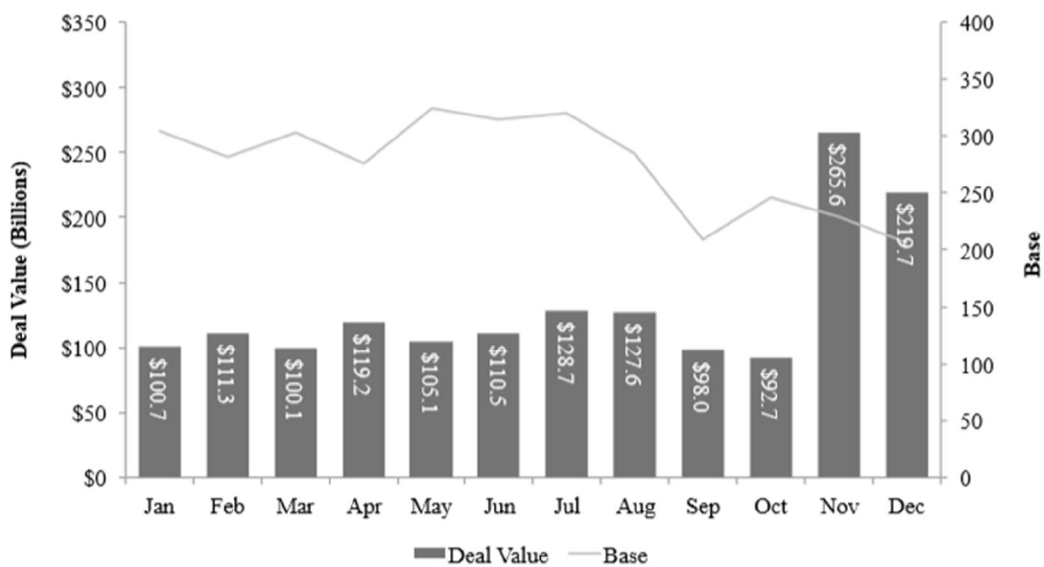


**Graph B.4:** The S&P 500 Index and Net M&A announcements by quarter, from 2013 to 2017.

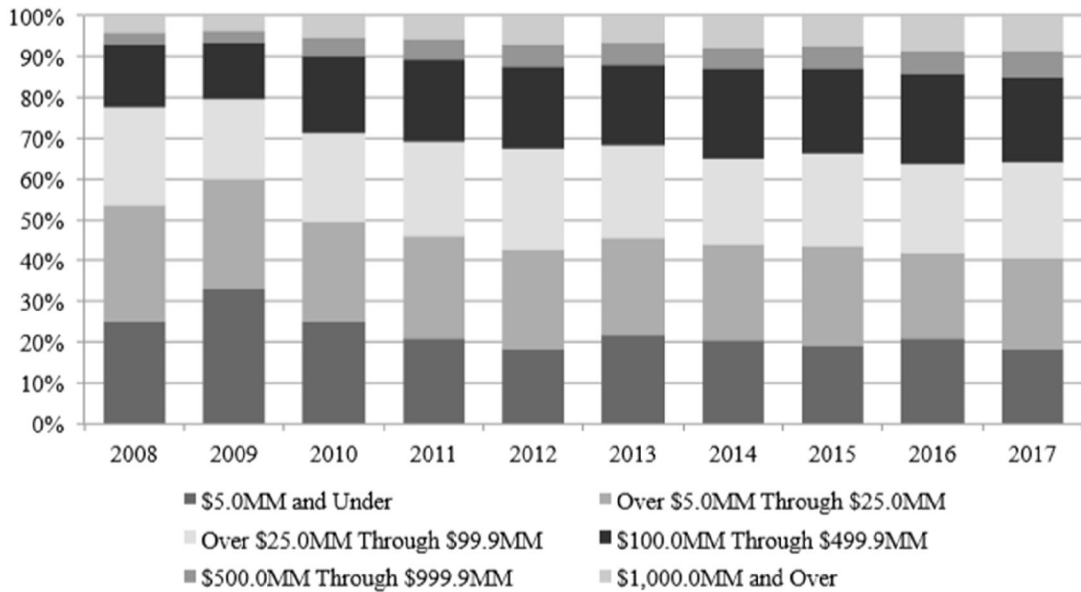
Source: Mergerstat Review 2018



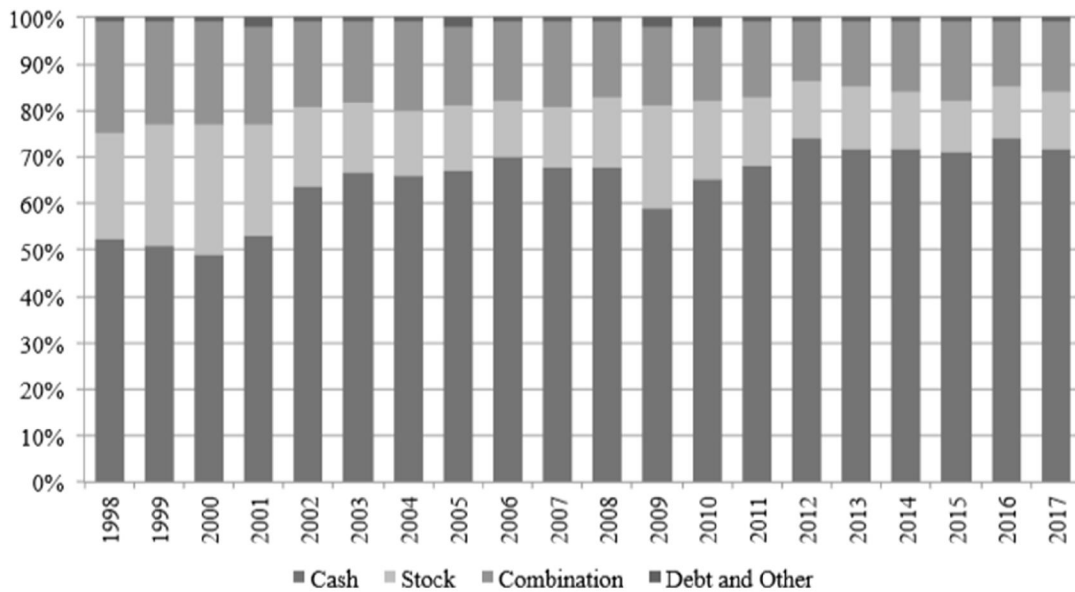
**Graph B.5:** Prime Interest Rate and Net M&A announcements by quarter, from 2013 to 2017.  
Source: Mergerstat Review 2018



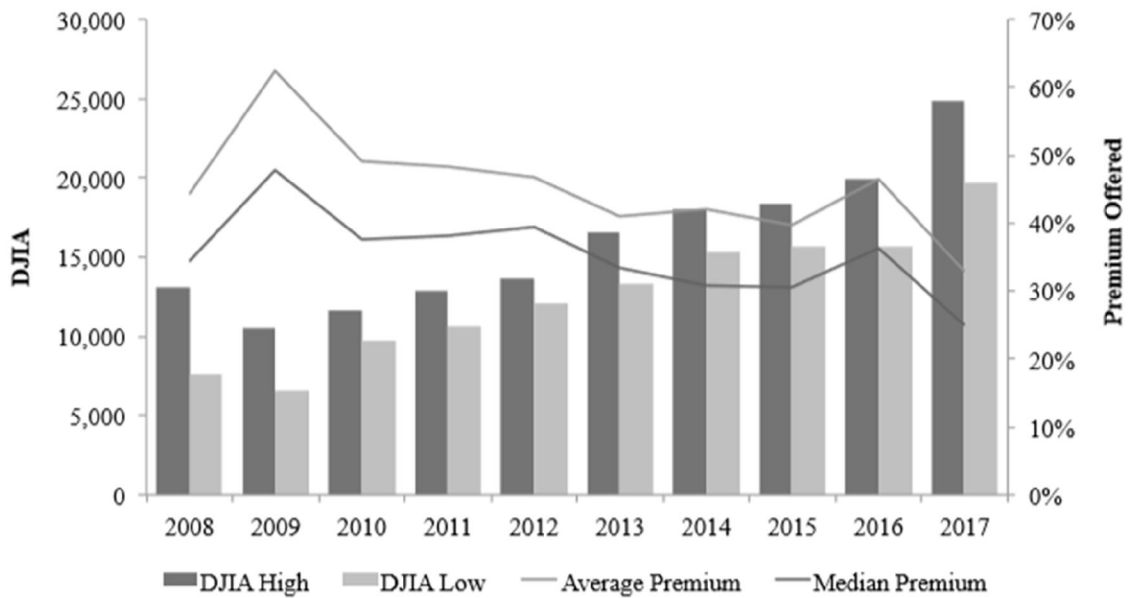
**Graph B.6:** Net M&A announcements: monthly breakdown by value, in 2017.  
Source: Mergerstat Review 2018



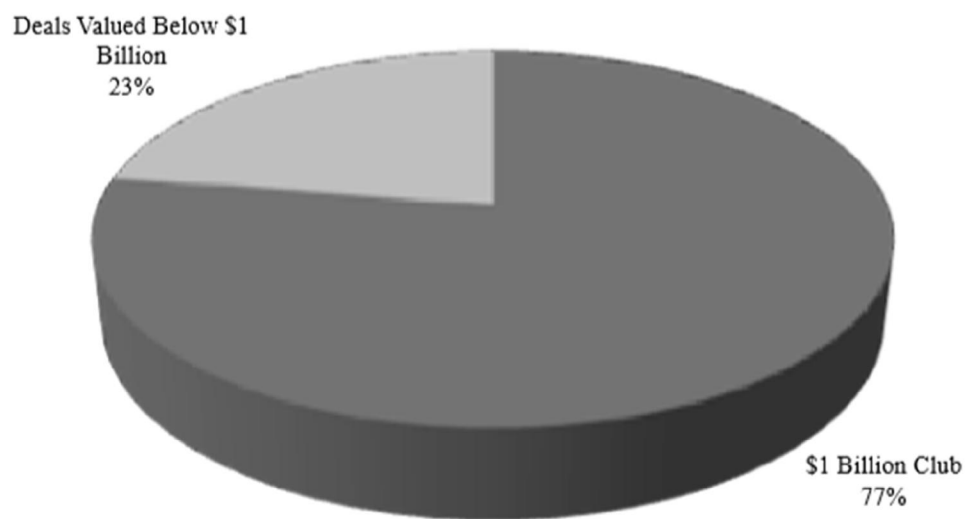
**Graph B.7:** Net M&A announcements purchase price distribution, from 2008 to 2017.  
Source: Mergerstat Review 2018



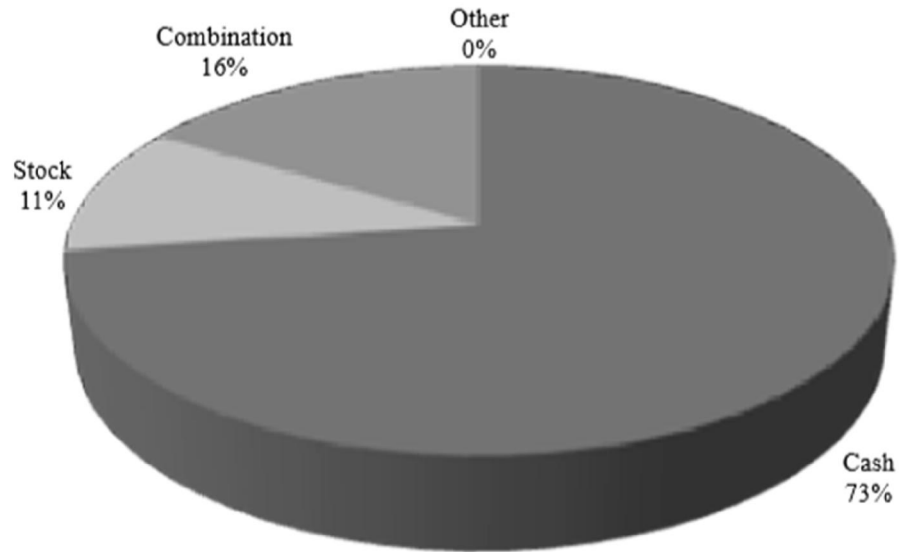
**Graph B.8:** Payment trends in M&A, from 1998 to 2017.  
Source: Mergerstat Review 2018



**Graph B.9:** Percent premium offered, from 2008 to 2017.  
 Source: Mergerstat Review 2018

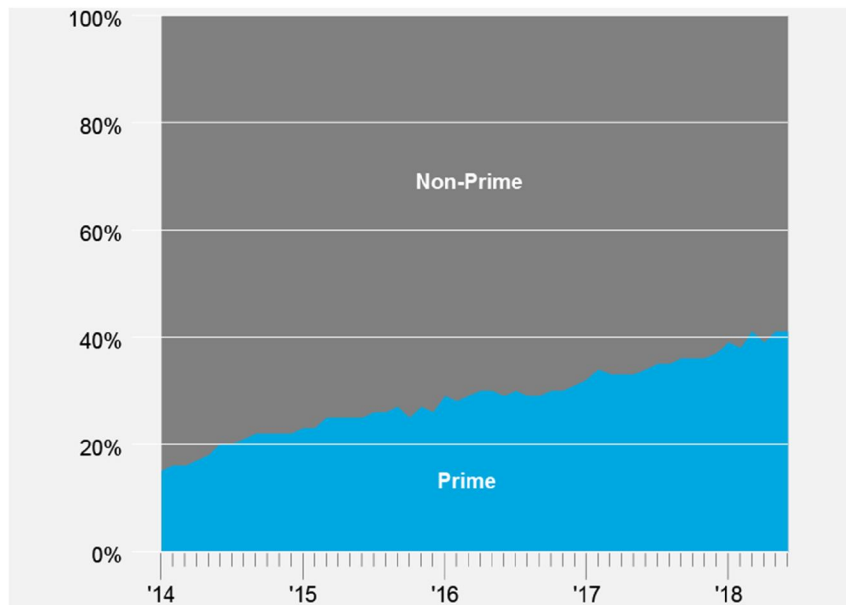


**Graph B.10:** Deal value composition, in 2017.  
 Source: Mergerstat Review 2018



**Graph B.11:** Method of payment composition for deals above \$1 billion, in 2017.  
Source: Mergerstat Review 2018

#### 4. Amazon's Prime Members among Whole Foods Market's customers



**Graph B.12:** Amazon's Prime Members among Whole Foods Market's customers.  
Source: Second Measure

## 5. Whole Foods Market's Key Indicators

	Industry Median	2015	2016	2017
Same Store Sales <i>1Y Growth</i>	-	2.50% <i>(1.8%)</i>	(2.50%) <i>(5.0%)</i>	(1.5%) <i>1.0%</i>
Gross Profit Margin <i>1Y Growth</i>	80%	35.2% <i>(0.3%)</i>	34.4% <i>(0.8%)</i>	33.7% <i>(0.7%)</i>
EBITDA Margin <i>1Y Growth</i>	42.3%	8.6% <i>(0.7%)</i>	8.7% <i>0.1%</i>	7.9% <i>(0.8%)</i>
Operating Margin <i>1Y Growth</i>	42.3%	5.6% <i>(1.0%)</i>	5.5% <i>(0.1%)</i>	2.9% <i>(2.6%)</i>
Pretax Margin <i>1Y Growth</i>	36.5%	5.7% <i>(1.0%)</i>	5.3% <i>(0.4%)</i>	2.6% <i>(2.7%)</i>
Effective Tax Rate <i>1Y Growth</i>	21.0%	39.0% <i>0.2%</i>	38.7% <i>(0.3%)</i>	41.2% <i>2.5%</i>
Net Margin <i>1Y Growth</i>	28.6%	3.5% <i>(0.6%)</i>	3.2% <i>(0.3%)</i>	1.5% <i>(1.7%)</i>
Asset Turnover <i>1Y Growth</i>	-	2.68 <i>6.5%</i>	2.60 <i>(2.9%)</i>	2.46 <i>(5.4%)</i>
Pretax ROA <i>1Y Growth</i>	-	15.3% <i>(1.5%)</i>	13.7% <i>(1.6%)</i>	6.4% <i>(7.3%)</i>
Pretax ROE <i>1Y Growth</i>	13.0%	23.2% <i>(1.4%)</i>	23.7% <i>0.5%</i>	12.5% <i>(11.2%)</i>
x Tax Complement <i>1Y Growth</i>	0.79	0.61 <i>(0.3%)</i>	0.61 <i>0.4%</i>	0.59 <i>(4.2%)</i>
ROE <i>1Y Growth</i>	10.8%	14.1% <i>(1.0%)</i>	14.5% <i>0.4%</i>	7.4% <i>(7.1%)</i>
x Earnings Retention <i>1Y Growth</i>	0.70	0.65 <i>(6.2%)</i>	0.66 <i>0.6%</i>	0.40 <i>(39.7%)</i>
Reinvestment Rate <i>1Y Growth</i>	7.6%	9.2% <i>(1.3%)</i>	9.5% <i>0.3%</i>	2.9% <i>(6.6%)</i>
ROIC <i>1Y Growth</i>	-	11.9% <i>(1.1%)</i>	10.7% <i>(1.2%)</i>	4.7% <i>(6.0%)</i>
Cash Cycle (Days) <i>1Y Growth</i>	(4.5)	11.7 <i>1.0%</i>	12.6 <i>8.4%</i>	12.2 <i>(3.5%)</i>
Assets/Equity <i>1Y Growth</i>	8.71	1.52 <i>1.1%</i>	1.97 <i>29.1%</i>	1.95 <i>(1.0%)</i>
Debt/Equity <i>1Y Growth</i>	0.13	0.02 <i>6.1%</i>	0.33 <i>&gt;99%</i>	0.32 <i>(3.1%)</i>
% LT Debt to Total Capital <i>1Y Growth</i>	1.5%	1.6% <i>0.1%</i>	24.5% <i>22.9%</i>	24.0% <i>(0.5%)</i>
(Total Debt- Cash)/EBITDA <i>1Y Growth</i>	(0.37)	- <i>-</i>	- <i>-</i>	0.23 <i>.</i>

**Table B.17:** Whole Foods Market's Key Indicators (annually).

Source: Thompson Reuters Eikon Database.

## 6. Interests of Whole Foods Market's Directors and Executive Officers in the merger

<b>Golden Parachute Compensation</b>				
<b>Name</b>	<b>Cash</b>	<b>Equity</b>	<b>Perquisites/Benefits</b>	<b>Total</b>
	(\$)	(\$)	(\$)	(\$)
John Mackey	-	-	-	-
Walter E. Robb, IV	-	55,760	-	55,760
Glenda Flanagan	2,571,423	525,765	4,158	3,101,346
Keith Manbeck	3,241,667	540,200	-	3,781,867
A.C. Gallo	2,571,423	1,236,186	17,478	3,825,086
David Lannon	2,571,423	382,710	13,338	2,967,471
Jason Buechel	5,705,635	529,957	4,680	6,240,272

**Table B.18:** Interests of Whole Foods Market's Directors and Executive Officers in the merger (1).

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

<b>Name</b>	<b>Severance Payment</b>	<b>Prorated Annual Bonus Payment</b>	<b>Accelerated Non-Compete Payment</b>
	(\$)	(\$)	(\$)
Glenda Flanagan	2,420,453	150,970	-
A.C. Gallo	2,420,453	150,970	-
David Lannon	2,420,453	150,970	-
Jason Buechel	2,354,665	150,970	3,200,000

**Table B.19:** Interests of Whole Foods Market's Directors and Executive Officers in the merger (2).

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

<b>Name</b>	<b>Company Stock Options</b>	<b>Company Restricted Stock Awards</b>	<b>Company Restricted Stock Unit Awards</b>
	(\$)	(\$)	(\$)
John Mackey	-	-	-
Walter E. Robb, IV	55,760	-	-
Glenda Flanagan	313,077	212,688	-
Keith Manbeck	120,200	-	420,000
A.C. Gallo	72,744	1,163,442	-
David Lannon	170,022	212,688	-
Jason Buechel	479,725	50,232	-

**Table B.20:** Interests of Whole Foods Market's Directors and Executive Officers in the merger (3).

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

Whole Foods Market's directors and executive officers were entitled to vote approximately 3,132,711 share of common stock (approximately 1.0% of the shares of common stock issued and outstanding on that date).

Amazon agreed to pay 2017's annual bonuses based on formulae previously established by Whole Foods Market and in a manner consistent with Whole Foods Market's historical practices related to discretionary amounts, if the closing occurs prior to the time that the Whole Foods Market has paid annual bonuses.

Certain Whole Foods Market's executive officers would participate in a retention plan, providing them employment protections during the two years following the deal. Moreover, Whole Foods Market's directors and executive officers were also entitled to continued indemnification and insurance coverage under indemnification agreements and the merger agreement (Whole Foods Market provided its shareholders with a separate advisory (non-binding) vote to approve certain compensations that may be paid or become payable to its named executive officers in connection with the merger). For more details, see section "*Whole Foods Market Executive Retention Plan and Non-Compete Arrangement*", of the definitive proxy statement concerning the acquisition.

## 7. Whole Foods Market's Projections

<b>Summary of the Whole Foods Market's Projections</b>					
<i>(dollars in millions)</i>					
	<b>2017</b>	<b>2018<sup>3</sup></b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Revenue	15,887	16,490	17,339	18,217	19,238
EBITDA <sup>1</sup>	1,216	1,331	1,656	1,815	1,949
Free Cash Flow <sup>2</sup>	324	422	639	738	814

**Table B.21:** Whole Foods Market's projections.

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

<sup>1</sup> EBITDA is defined for purposes of the Whole Foods Market Projections as earnings before interest expense, investment and other income, income taxes and depreciation and amortization. This measure is different from measures determined in accordance with U.S. GAAP and may not be comparable to similar measures used by other companies and should not be considered as an alternative to operating income or net income as a measure of operating performance or cash flow or as a measure of liquidity. EBITDA in 2017 excludes charges incurred for a severance payment and store and facility closures.

<sup>2</sup> Free Cash Flow is defined for purposes of the Whole Foods Market Projections as net cash provided by operating activities less capital expenditures.

<sup>3</sup> Estimates in 2018, a 53-week fiscal year, are presented on a 52-week basis.

<b>Reconciliation of Projected EBITDA to Projected Net Income</b>					
<i>(dollars in millions)</i>					
	<b>2017<sup>1</sup></b>	<b>2018<sup>2</sup></b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Net Income	409	470	658	739	794
Provision for income taxes	262	300	420	473	507
Interest expense	47	47	47	47	47
Investment and other income	(8)	(14)	(20)	(29)	(33)
<b>Operating income</b>	<b>710</b>	<b>803</b>	<b>1,105</b>	<b>1,230</b>	<b>1,315</b>
Depreciation and amortization	506	528	551	585	634
<b>EBITDA</b>	<b>1,216</b>	<b>1,331</b>	<b>1,656</b>	<b>1,815</b>	<b>1,949</b>

**Table B.22:** Whole Foods Market's projections – complementary information (1).

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

<sup>1</sup> EBITDA in 2017 excludes charges incurred for a severance payment and store and facility closures.

<sup>2</sup> Estimates in 2018, a 53-week fiscal year, are presented on a 52-week basis.

<b>Reconciliation of Projected Free Cash Flow to Projected Net Cash Provided by Operating activities</b>					
<i>(dollars in millions)</i>					
	<b>2017</b>	<b>2018<sup>1</sup></b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Net cash provided by operating activities	1,019	1,079	1,293	1,420	1,532
Development costs of new locations	(370)	(343)	(340)	(367)	(402)
Other property and equipment expenditures	(325)	(314)	(314)	(315)	(316)
<b>Free Cash Flow</b>	<b>324</b>	<b>422</b>	<b>639</b>	<b>738</b>	<b>814</b>

**Table B.23:** Whole Foods Market’s projections – complementary information (2).

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

<sup>1</sup> Estimates in 2018, a 53-week fiscal year, are presented on a 52-week basis.

These projections constitute set of non-public, unaudited financial forecasts with respect to Whole Foods Market’s business, as a standalone company (without considering the possible financial and other effects on the company of the merger, or its failure), that were presented to the company’s board of directors and its financial advisors. These projections are based on expectations regarding important risk factors and should not be regarded as a representation that the results expressed therein will be achieved. The definitive proxy statement also includes, in the section “*Cautionary Statement concerning Forward-Looking Statement*”, several factors that could cause the results to differ materially from those presented above.

As presented on Form 10-Q (filed by Whole Foods Market on February 16<sup>th</sup>, 2017), for the fiscal year 2017, Whole Foods Market was targeting:

- Sales growth of 1.5%, or greater;
- Comparable store sales of approximately -2.5%, or better;

- Ending square footage growth of approximately 5% net of closures, reflecting approximately 30 new stores, including up to six relocations and 3 “365 Stores”;
- Diluted EPS of \$1.33, or greater;
- EBITDA margin of approximately 8%;
- Capital Expenditures of approximately 4% of sales;
- ROIC of approximately 11%.

Additionally, as presented by Whole Foods Market through the Form 8-K (filed by the company, on May 10<sup>th</sup>, 2017), the company also expected to achieve, by FYE 2020, the following targets:

- Total sales of over \$18 billion;
- Comparable store sales growth greater than 2.0%;
- Selling, General & Administrative Expenses as a percentage of sales less than 27%;
- EBITDA margin greater than 9.5%;
- Cash-flow from operations of over \$1.2 billion;
- Realizing \$300 million in additional cost savings.

## 8. Voting results from Whole Foods Market’s Special Meeting to approve the Merger Agreement

Votes cast “FOR”		Votes cast “Against”		Abstain	Broker non-votes
Number	% of shares outstanding	Number	% of shares outstanding		
229,534,195	71.68%	967,493	0.30%	708,524	41,447,539

**Table B.24:** Voting results from Whole Foods Market’s Special Meeting to approve the Merger Agreement.

Source: Form 8-K filed by Whole Foods Market, Inc. on August 28th, 2017.

At the Special Meeting, held on July 19<sup>th</sup>, 2017, a total of 272,657,751 Whole Foods Market's shares, representing approximately 85.15% of the outstanding shares entitled to vote, were present in person or by proxy, constituting a quorum to conduct business.

## 9. Aggregate number of securities to which the transaction applies

Type of Security	Number of Securities
Shares of common stock outstanding	320,092,231
Shares of common stock issuable pursuant to outstanding options with exercise prices below the per share merger consideration	14,805,687 <sup>1</sup>
Shares of common stock issuable pursuant to outstanding stock appreciation rights with exercise prices below the per share merger consideration	15,750 <sup>2</sup>
Shares of common stock representing restricted stock and restricted stock units entitled to receive the per share merger consideration	101,733

**Table B.25:** Aggregate number of securities to which the transaction applies, as in July 2<sup>nd</sup>, 2017.

Source: Definitive Proxy Statement (DEFM14A), filed by Whole Foods Market, Inc. on July 21st, 2017.

<sup>1</sup> Weighted average exercise price equal to \$33.66.

<sup>2</sup> Weighted average exercise price equal to \$34.24.

The maximum number of securities to which the deal applies is estimated to be 335,015,401. The maximum aggregate value of acquisition is estimated to be \$13,571,748,138, and results from the sum of: (a) the product of 320,092,231 shares of common stock and the per share merger consideration of \$42.00; (b) the product of (i) 14,805,687 shares of common stock issuable upon exercise of options to purchase

shares of common stock and (ii) the difference between \$42.00 and the weighted average exercise price of such options of \$33.66; (c) the product of (i) 15,750 shares of common stock issuable pursuant to stock appreciation rights and (ii) the difference between \$42.00 and the weighted average exercise price of such stock appreciation rights of \$34.24; and (d) the product of 101,733 shares of common stock representing restricted stock and restricted stock units and the per share merger consideration of \$42.00.

Amazon did not possess any WFM's shares prior to the acquisition (toehold). Toehold is one way to mount a profitable bid, acquire some share at "discount" – i.e. without including a control premium, or the discounted value of future synergies – and can also allow a premium/compensation if the company loses the deal to another bidder. However, this strategy is rare nowadays and it is more common in hostile acquisitions.

## 10. Amazon's Key Indicators

	Industry Median	2016	2017	2018
# Stores	-	-	472	527
<i>1Y Growth</i>			-	11.7%
Gross Profit Margin	27.6%	35.1%	37.1%	40.2%
<i>1Y Growth</i>		2.1%	2.0%	3.1%
EBITDA Margin	13.3%	9.0%	8.8%	10.7%
<i>1Y Growth</i>		1.0%	(0.2%)	1.9%
Operating Margin	9.4%	3.1%	2.3%	5.3%
<i>1Y Growth</i>		1.0%	(0.8%)	3.0%
Pretax Margin	6.2%	2.9%	2.1%	4.8%
<i>1Y Growth</i>		1.4%	(0.8%)	2.7%
Effective Tax Rate	24.5%	36.6%	40.9%	12.0%
<i>1Y Growth</i>		(24.0%)	4.3%	(28.9%)
Net Margin	4.6%	1.8%	1.3%	4.3%
<i>1Y Growth</i>		1.2%	(0.5%)	3.0%
Asset Turnover	1.01	1.84	1.66	1.58
<i>1Y Growth</i>		2.3%	(9.8%)	(4.4%)
Pretax ROA	5.6%	5.3%	3.5%	7.7%
<i>1Y Growth</i>		2.7%	(1.8%)	4.2%
Pretax ROE	11.1%	23.8%	16.2%	31.6%
<i>1Y Growth</i>		10.8%	(7.6%)	15.4%
x Tax Complement	0.87	0.61	0.80	0.89
<i>1Y Growth</i>		60.3%	30.8%	12.2%
ROE	12.8%	14.5%	9.6%	27.8%
<i>1Y Growth</i>		9.6%	(4.9%)	18.2%
x Earnings Retention	0.69	1.00	1.00	1.00
<i>1Y Growth</i>		0.0%	0.0%	0.0%
Reinvestment Rate	5.6%	14.5%	9.6%	27.8%
<i>1Y Growth</i>		9.6%	(4.9%)	18.2%
ROIC	-	7.0%	4.0%	11.8%
<i>1Y Growth</i>		4.8%	(3.0%)	7.8%
Cash Cycle (Days)	48.2	(30.9)	(30.9)	(28.6)
<i>1Y Growth</i>		(12.5%)	0.2%	7.3%
Assets/Equity	2.15	4.32	4.74	3.73
<i>1Y Growth</i>		(10.6%)	9.6%	(21.2%)
Debt/Equity	0.54	1.06	1.59	1.13
<i>1Y Growth</i>		(0.1%)	50.5%	(29.0%)
% LT Debt to Total Capital	25.5%	38.3%	52.8%	42.9%
<i>1Y Growth</i>		(13.1%)	14.5%	(9.9%)
(Total Debt- Cash)/EBITDA	2.62	-	0.24	0.42
<i>1Y Growth</i>			-	73.9%

**Table B.26:** Amazon's Post-Acquisition Key Indicators (annually).

Source: Thompson Reuters Eikon Database.

The deal also added a set of additional risks to Amazon. In brief, we highlight the following: loss of focus by its managers on existing businesses; potential impairment of customer and other relationships of WFM, or their own customers; unanticipated expenses related to integrations; additional specific risks associated with WFM's business (which may differ from or be more significant than those from their businesses); unknown liabilities; and increasing competition, given that WFM's competitors were experimenting click-and-collect programs and cashierless technology.

## 11. Amazon's Segments

<b>Segment</b>	<b>Total Revenue per Segment (percentage of Amazon's Total Revenue)</b>
Amazon Web Services	\$25,655,000,000 (11.02%)
Online Stores	\$122,987,000,000 (52.81%)
Other Services	\$10,108,000,000 (4.34%)
Physical Stores	\$17,224,000,000 (7.4%)
Subscription Services	\$14,168,000,000 (6.08%)
Third Party Seller Services	\$42,745,000,000 (18.35%)
<b>Total</b>	<b>\$232,887,000,000 (100%)</b>

**Table B.27:** Amazon's Revenue by Segment (2018).  
Source: Thompson Reuters Eikon Database.