

Amazon-Whole Foods Markets Tie-Up

CAN LOVE CONQUER ALL?

By Jay Jacobowitz

Does Amazon care what it sells?

Does Whole Foods Markets care what it sells?

The opposing answers to these two questions—“No” and “Yes” respectively—are at the heart of the problem Amazon CEO, Jeff Bezos, now hopes to solve. Put another way, can Bezos make fresh, organic, free-range filet mignon behave like J.R.R. Tolkien’s latest novel, *Beren and Lúthien*, on an Amazon Prime delivery truck?

Click-&-Collect?

But wait, you say, Amazon doesn’t want to deliver, it wants Whole Foods Markets for its nationally installed base of roughly 450 domestic stores, ideally situated just blocks from the critical mass of trend-forward Boomer and Millennial customers Amazon covets for...click-and-pick-up? Let’s look at the “Whole Foods Market as fresh-food delivery point” model.

The perishables pick-up point argument goes, with Amazon Prime, Bezos has got third-party delivery of non-perishables down to a science. But transporting fresh foods over the expensive last mile has been problematic. Witness Amazon Fresh, the company’s faltering attempt at self-delivery in select urban areas for an additional \$14.99 per month, on top of the Amazon Prime monthly fee. Amazon appears to have concluded this is not scalable. Hence, the Whole Foods acquisition. With this move, Amazon’s all-important existing base of urban Prime customers will have a new benefit of picking up their highest-quality perishable foods at their 450 local Whole Foods Markets...at a lower price than if they simply shopped at the store themselves?

Wait a minute. How is adding an internet order placed through Amazon, transmitted to the local Whole Foods store, selected by an Amazon/Whole Foods employee, stored in an as-yet-to-be-built dedicated refrigerated space (have you seen the tight layouts of some of Whole Foods’ urban stores?), and picked up by the customer, going to be cheaper than simply shopping at the store?

Combining Amazon’s estimated \$9 billion in food sales with Whole Foods’ \$16 billion gives the new company about a 4 percent grocery market share, behind Walmart, Kroger, Safeway/Albertsons, and Costco, and about the level of Southeast regional, Publix. Is this game-changing buying power, or just another chance to lose more money before the investment community wakes up? (Amazon makes an estimated less than 1% operating margin on its \$123 billion (!) in retail sales, and 25% operating margin on its \$12 billion Amazon Web Services (AWS) unit, so three out of four dollars total operating profit come from AWS.) AWS provides cloud-computing to companies that wish to analyze, store, and deploy data from remote servers without having to own and maintain in-house hardware and software. Netflix, for example, uses AWS to stream its video content to subscribers.

Data-Driven In-Store Shopping?

It doesn't *need* to be cheaper, you say, (Amazon Prime customers apparently don't bother checking prices.) It's about creating massive convenience from mining all the data Amazon will have. Amazon's algorithmic knowhow will create an intuitive, super-fast shopping experience; automated shopping list suggestions, personalized deals, cashier-less checkouts, and other yet-to-be-developed technological enhancements to brick-and-mortar shopping other analog-world competitors can't possibly achieve. Perhaps, but are we sure automated convenience is shoppers' greatest aspiration?

A Perishables Trucking Company?

Well, with stores so close to the customer, you say, maybe Amazon/Whole Foods *can* deliver profitably. With savings from the rumored labor cuts in stores, Amazon can hire a delivery workforce. How will they deliver? On foot? By bicycle? Delivery truck? Do any of Amazon's renowned skills in non-perishable fulfillment-center efficiency translate to hand delivering individual customer perishables orders? No.

In announcing the deal to Wall Street, Jeff Bezos didn't bother outlining a strategy, and in his presentation to the troops at Austin, John Mackey, aside from professing love at first sight of Bezos, proclaiming a "day of magic" (yes, it's in the SEC transcript), pixie dust, and well, just amazing excitement, was skimpy on detail as well.

Here's what I think. With this move, John Mackey's activist investor problem (Jana Partners, Neuberger Berman), two-year track record of negative same-store sales problem, and so-far-underwhelming results from the new format 365 discount-store problem, all go away. For Bezos, he's simply cashing in on the market's continuing willingness to suspend disbelief that high-profile tech companies will eventually turn a profit, no matter what experiments they try.

But in order to be a game-changer in fresh foods—an area that has so far eluded Amazon—the company will have to invest in solving the problem of delivering the last mile at scale. As a first step, perhaps Amazon recognizes it needs Whole Foods' brand credibility to give it any hope of achieving critical mass in perishables.

Or, maybe love can conquer all. In the meantime, I think Mackey is pretty smart to take the \$13.7 billion cash pre-nuptial. **JJ**