

Winslow Environmental News

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APRIL 2005

FEATURED COMPANY

The Whole Story on Whole Foods

BY ELLEN PFEIFER

Shopping at a Whole Foods Market is not like walking into yesterday's hippie health foods shop. No grungy storefronts, undersized



organic veggies, or strange smells emanating from weird nutritional supplements. Prosperous and in some places ubiquitous, Whole Foods Markets (WFMI) has created a new paradigm, offering the allure of the gourmet good life while promising physical and environmental well being.

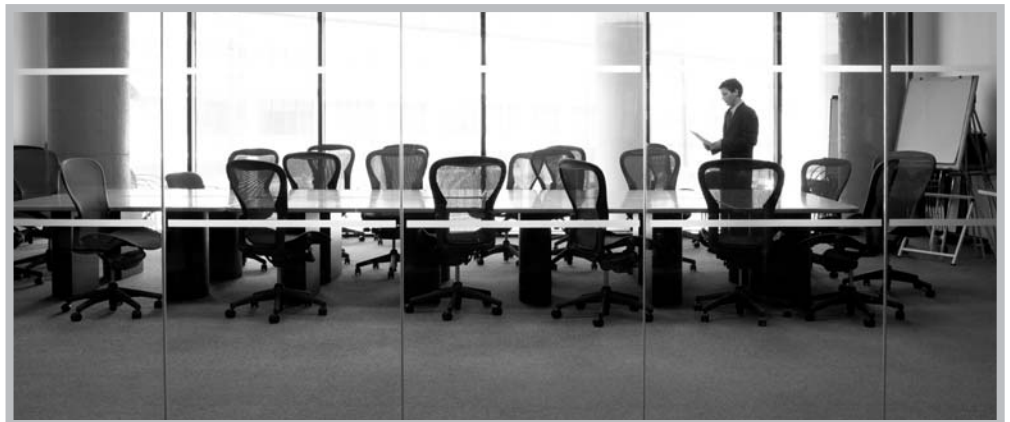
At Whole Foods, affluent suburban moms can choose pesticide-free apples for their kids; meat lovers can find free-range

Please see *WHOLE FOODS* page 7

CORPORATE GOVERNANCE 101

BY ELIZABETH LEVY AND ERICA SCHROEDER

ENRON. WORLD.COM. QWEST. TYCO. ADELPHIA. GLOBAL CROSSING. THE BEGINNING OF THIS DECADE HAS SEEN A DISAPPOINTING NUMBER OF "CORPORATE SCANDALS"— FAILURES BY COMPANIES TO MEET BEHAVIORAL EXPECTATIONS OF STAKEHOLDERS, INCLUDING EMPLOYEES AND SHAREHOLDERS, OFTEN IN ORDER TO MEET PERFORMANCE EXPECTATIONS. THESE FAILURES HAVE FOCUSED THE INVESTMENT COMMUNITY'S ATTENTION ON CORPORATE GOVERNANCE, CAUSING INVESTORS TO SCRUTINIZE THE PROCEDURES BY WHICH CORPORATIONS ARE DIRECTED AND CONTROLLED.



A Wake-Up Call

The federal government's immediate reaction to the scandals was to pass the Sarbanes-Oxley Act in 2002, setting out many new governance requirements for public companies listed on U.S. stock exchanges. For example, Sarbanes-Oxley requires executives to certify annual and quarterly reports personally, and forces companies to assess their internal controls over financial reporting and state in their annual reports whether the controls are operating effectively.

While some argue that Sarbanes-Oxley places an onerous burden on management, investors can appreciate strengthened corporate governance. Defining exactly what comprises strong or weak corporate governance, however, can be quite challenging. How do companies balance the competing interests of shareholders, employees, and customers? How can entrepreneurial executives with a specific vision for a company ensure that the company's culture is upheld when it goes

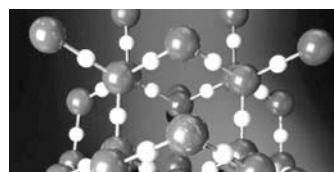
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MARKETBEAT PAGE 2

Superior Boards, Superior Returns?

Examining the link between corporate governance and shareholder returns



PORTFOLIO UPDATE PAGE 6

Martek Inks Deal with Kellogg Co.

Enters license and supply agreement to provide docosahexaenoic acid (DHA)

Forging the Link: Corporate Governance and Shareholder Returns

BY JACKSON W. ROBINSON

WINSLOW PRESENTATION IN FLORIDA

In late February, Jack Robinson presented “G2: The Case for Green Investing” at Florida State University to an audience of students, faculty, and community members. Robinson discussed global, national and regional environmental challenges and potential solutions to highlight the importance of these issues. He then introduced green investing and responsible purchasing and provided sources for more information on these topics.

The slides from the presentation are available on our website, in the “Winslow in the News” section. www.winslowgreen.com.

CORRECTION: WGI PERFORMANCE

In the January edition of *Winslow Environmental News*, the performance data should have read that the Winslow Green Index has increased 124% from its August 1999 inception through December 2004. The index rose 15.6% during the calendar year 2004.*

The buzz in boardrooms and newspapers across America is corporate governance, but the subject isn't always generating ringing endorsements. While some directors view governance as a costly nuisance and potential liability, we have found a growing body of research that demonstrates that solid corporate governance is an asset that enhances shareholder returns.

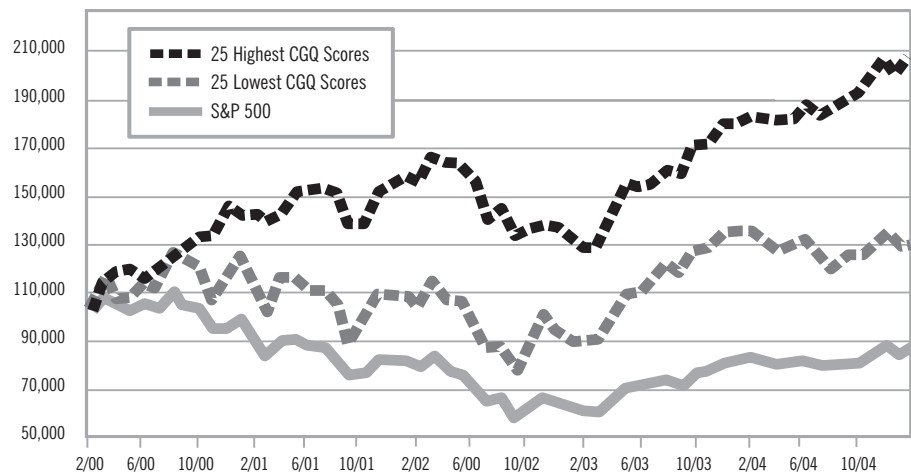
Winslow has long been a proponent of green and social screening of companies as indicators of overall management quality. Although these metrics are somewhat difficult to measure, we believe they are indicative of a company's ability to compete successfully, thereby improving profitability and shareholder returns. More recently, and as discussed elsewhere in this issue of *Winslow Environmental News*, we have incorporated corporate governance into our screening process

and found that it adds incremental value to our stock selection process.

In our 20 years of doing environmental research on corporations, we have noted anecdotally that there is a cultural connection between environmental, social and governance polices. More recently, and in the wake of the Adelphia, Enron and WorldCom meltdowns, we have read several third-party studies that show a positive correlation between strong corporate governance polices and strong shareholder returns, which we summarized in the cover article of this issue.

In the first quarter of 2005, we did our own performance back-test using information provided to us by Institutional Shareholder Services' (ISS) Corporate Governance Quotient (CGQ), one of several ratings services profiled in this issue. The results speak for themselves.

Highest and Lowest CGQ-Scoring S&P 500 Companies (5 yr)



The performance of the Highest and Lowest CGQ scoring indices do not represent actual trading in a client or proprietary account or the performance of securities selected on a prospective basis. Winslow selected companies for these indices based on their CGQ scores provided by ISS on February 16, 2005. The S&P 500 is an unmanaged index that includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Returns for the S&P are calculated monthly, assume reinvestment of dividends and, unlike an investment in a mutual fund or other account, do not reflect any fees, charges or expenses. An investor cannot invest directly in the S&P. **Past performance is not indicative of future results.**

ISS provided Winslow with its CGQ rankings as of mid-February 2005 for the companies in the S&P 500. Using publicly available data, we compared the stock performance of the 10 and 25 companies with the highest CGQ scores to those with the lowest 10 and 25 scores over the last one, three, and five years on an equally weighted basis. In all six comparisons, the companies with the highest CGQ ratings outscored the lowest rated companies as shown in the performance table. As you can see in the attached chart, the five-year 25 stock comparisons favored the top 25 CGQ companies by +76.6%, a compelling case for strong corporate governance.

One of the problems with back-tests is a phenomenon called survivorship – such tests may exclude some companies that have been acquired or gone bankrupt. We feel that the spread we found between the top and bottom CGQ scorers may actually be conservative, because several of the companies with abysmal governance that were listed in the S&P 500 five years

ago have since gone bankrupt and so were not included in the low-scoring groups that we compare in February 2005. For example, in October of 2001, Global Crossing was removed from the S&P 500 after exposure of accounting irregularities and egregious CEO payments. The next month, Enron left the index and lent its name to the new era of business, post-Enron. WorldCom was removed in May 2002 for another case of accounting fraud. Conseco, with outrageous executive compensation

and super-sized loans to executives for stock purchases, was removed from the index in July 2002. All of these companies subsequently filed for bankruptcy protection. Attentive boards operating in an environment of strong corporate governance should have prevented these failures, avoiding tremendous investor losses.

To further this point, we re-read the Adelphia 2001 proxy statement, the last proxy before members of Adelphia's ruling family were charged with conspiracy, fraud and racketeering. The striking lack of board and auditor independence, the related party transactions, the excessive non-audit fees paid to the auditor and the convoluted

Relative Performance: Returns of the Best and Worst CGQ Scoring Companies

	1 YEAR	3 YEAR	5 YEAR
Top 10 CGQ scores	11.2%	17.7%	88.8%
Bottom 10 CGQ scores	0.4%	16.6%	42.0%
Difference	10.8%	1.1%	46.8%
Top 25 CGQ scores	14.0%	33.5%	108.9%
Bottom 25 CGQ scores	-2.8%	27.7%	32.3%
Difference	16.8%	5.8%	76.6%

capital structure in and of themselves would have contributed to a very low CGQ rating. Not surprisingly, Adelphia has also since gone bankrupt.

Given these positive correlations and increasing media attention, we anticipate that every investment professional will be seeking out companies with strong corporate governance ratings in the future, thereby further increasing premiums paid for companies that already have strong environmental and social ratings. □

We have incorporated corporate governance into our screening process and found that it adds incremental value to our stock selection process.

* The Winslow Green Index (WGI) is an equally weighted index of 100 "green-screened" stocks of U.S.-based corporations selected by Winslow Management Company. Winslow began calculating the WGI in August 1999. From August 1, 1999 through September 30, 2003 there were no changes to the securities that comprised the index. As of September 30, 2003 Winslow began reviewing the securities that comprise the index before the first day of each calendar quarter. The results of the WGI do not reflect the results of actual trading in a client or proprietary account managed by Winslow. Returns for the WGI are calculated monthly, assume reinvestment of dividends and, unlike an investment in a mutual fund or other account, do not reflect any fees, charges or expenses. An investor cannot invest directly in the WGI. **Past performance is not indicative of future results.**

Energized by the corporate scandals and their new political clout, investors are increasingly exercising their rights as shareholders to elect board members and to vote their proxies on resolutions at annual general meetings.

GOVERNANCE continued from page 1

public? What are the tradeoffs implied by certain progressive corporate governance practices, such as flexibility versus stability in the case of classified and declassified boards? The adjacent box contains a list of several emerging corporate governance issues, as well as a handful of the more progressive solutions recently advocated.

While corporate governance may be the number one issue in some investors' minds, many others, including some advocacy organizations, see it as linked with a larger universe of social concerns. For example, the Coalition for Environmentally Responsible Economies (CERES) and the Investor Responsibility Research Center (IRRC) co-sponsored a June 2003 report called "Corporate Governance and Climate Change: Making the Connection."

According to Douglas Cogan, Director of Social Issues at IRRC and author of the report, there is not only "a connection between climate change and corporate governance, but [a] connection between how institutional investors analyze corporate

behavior relative to any issue that may come before them."

A New Set of Tools

In response to the increasing importance of corporate governance issues to both investors and corporations, a number of services have emerged to assist in the analysis of corporate governance criteria. They have not only established criteria for measuring performance, but also rate companies according to those metrics. For example, Rockville, Maryland based Institutional Shareholder Services (ISS) offers the Corporate Governance Quotient (CGQ), which compares companies to both their market index (e.g., S&P 500) and their specific industry (e.g., Software and Services). Similarly, the Corporate Library, a research

firm in Portland, Maine, offers a Board Effectiveness Rating, in addition to corporate governance and company research sources. IRRC's Corporate Governance Benchmarker service provides data on U.S. companies but does not rate them. While each of these services is different, together their

Emerging Important Corporate Governance Factors

- Moderately sized board – ISS recommends that board size ideally range from 9-12 members
- Majority independent versus inside directors on the board
- Separation of chairman and CEO
- Avoidance of CEO conflicts of interest
- Independent directors on the compensation, audit, and nominating committees
- Annual election of all directors, rather than staggered terms (referred to as a declassified board)
- Good attendance records (e.g., at least 75%) for all directors, including at committee meetings
- Fair compensation and severance packages for executives and directors
- Simple majority requirements to pass resolutions, elect directors and amend by-laws
- Single voting class of shares
- Significant ownership by executives and directors
- Investor-friendly characteristics of anti-takeover measures (the "poison pill"), if present
- Review of non-audit fees paid to the auditor firm

Progressive Practices

- Board guidelines published in the annual proxy statement
- Diversity of board and management members
- Meetings of independent board members

Adapted from ISS and IRRC

existence and abundance demonstrate the growing interest of investors in governance issues.

Energized by the corporate scandals and their new political clout, investors are increasingly exercising their rights as shareholders to elect board members and to vote their proxies on resolutions at annual general meetings. Many investors, including institutional investors such as the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF) and state pension plans such as the California Public Employees' Retirement System (CalPERS), have recently been voting more frequently against management on proxy resolutions or withholding votes from directors to express displeasure with a company's governance.

TIAA-CREF, which represents more than two million individuals, has been a supporter of shareholder rights and sound corporate governance for many years. Peter Clapman, TIAA-CREF's Senior Vice President and Corporate Counsel for Corporate Governance, explains, "More investors now appreciate the link between value and a serious corporate governance engagement. At a very minimum, corporate governance is a good measure of risk... [and] corporate governance problems affect portfolio risk as well as return."

TIAA-CREF relies mainly on confidential talks with executive management to encourage "sound corporate governance." However, TIAA-CREF and other investors can also sponsor shareholder resolutions on specific actions to be included in the proxy statement for companies' annual meetings. IRRRC reported that in 2004, shareholders sponsored 450 corporate governance proposals; out of those, 133 received a majority vote. While a company's management is not obliged to act on majority vote resolutions, and often will not, it can adopt the changes requested in a shareholder resolution. For example, in 2003, Amalgamated Bank of Longview sponsored a resolution requesting that Whole Foods Market (see Featured Company in

this issue) declassify its board and move to a system where all directors are elected annually. Over 60% of Whole Foods shareholders voted for the resolution, and the board amended the bylaws accordingly. (For information on Winslow's proxy voting, see accompanying sidebar.)

A New Relationship

Many corporate leaders have responded negatively to the increased attention paid to corporate governance practices. A survey in *CFO Magazine's* September 2004 issue found that 11% of Chief Financial Officers felt that adopting governance practices advocated by investors such as CalPERS would improve their company's ability to create value, while 42% believed it would reduce it. Many new academic and professional studies present data that disagree with that opinion, however. Reviewing a number of these recent studies, a January 2005 report by Hermes, a British fund manager with approximately £49 (\$94) billion under management at the end of 2004, concludes that "the governance-ranking research on the whole supports the proposition that good corporate governance enhances performance." (See Marketbeat in this issue for similar findings from Winslow.)

The "post Enron" era has witnessed a shift in the relationships between companies' management, directors and shareholders. Shareholders now include governance among the factors that they use to assess investments, recognizing a link between strong governance and strong performance. What's more, they are willing act on their convictions. As American Electric Power CFO Susan Tomasky noted in *CFO*, the time has come when "we do have to get over the notion some executives have that shareholders ought not to care about governance issues." □

This article is a summary from a Winslow white paper entitled "Corporate Governance 101: An Introduction for Investors." The complete text of the white paper is available on-line, in the "Green Investment Studies" section of our website, www.winslowgreen.com.

We welcome feedback sent to inquiry@winslowgreen.com.

WINSLOW'S CORPORATE GOVERNANCE ACTIVITIES

Winslow has long been aware of and interested in the basic corporate governance principles of our portfolio companies. Over the past year, however, we have been strengthening our own corporate governance work. With the publication of April's *Winslow Environmental News*, which highlights the importance of corporate governance to investors, we are highlighting the work we do in two areas: corporate governance screening and proxy voting.

Winslow began including corporate governance factors as part of our environmental review process in 2003, initially considering a few factors such as board independence. Our current environmental review includes a full section on corporate governance practices, such as board structure, board committee composition, director attendance records, capital structure, board and management compensation, and board and management diversity. Winslow now considers this information during the environmental review process.

An SEC rule required that mutual funds begin annually disclosing their proxy voting records in the summer of 2004. While proxy vote records for all mutual funds can now be found on the SEC's website, Winslow has also posted the record for the Winslow Green Growth Fund on our website to make it more accessible for our own stakeholders. In addition, we have posted the guidelines that inform our voting, prepared by the Social Investment Research Service of Institutional Shareholder Services (ISS). This information is available on our website, www.winslowgreen.com in the "Investment Approach" section.

PORTFOLIO UPDATE

Durect Corporation

(NASDAQ: DRRX)

CUPERTINO, CA – Durect announced in February the initiation of the Phase II program for the company's Transdur-based Sufentanil patch. Durect is a specialty pharmaceutical systems company focused on the development of pharmaceutical systems based on its proprietary drug delivery platform technologies that treat chronic debilitating diseases and enable biotechnology products. The Transdur-Sufentanil patch is intended to provide extended pain relief for up to seven days, as compared to the three days of relief provided with currently available opioid patches. The objectives of the Phase II program are to evaluate the pharmacokinetics, efficacy and safety of repetitive applications of the sufentanil patch in chronic pain patients for a period of up to four weeks.

"The initiation of the Phase II program for the Transdur-Sufentanil patch is an important milestone for us. We have been able to move this program rapidly from Phase I in October 2004, in part due to our Phase II and dose conversion data from the clinical studies with our

Chronogesic product," said James E. Brown, Durect's President and CEO. "Our previous experience with the systemic delivery of sufentanil in approximately 100 patients with Chronogesic is directly applicable to the development of our Transdur-Sufentanil patch."

Martek Biosciences Corporation

(NASDAQ: MATK)

COLUMBIA, MD – Martek, a supplier of omega fatty acids that support cardiovascular health, announced in early February that it has entered into a 15-year, non-exclusive license and supply agreement with Kellogg Co. to provide docosahexaenoic acid (DHA), an omega-three fatty acid. Under this agreement, Kellogg will develop foods containing Martek DHA and must display the Martek DHA logo on all product packages, print advertisements and certain other promotional materials. The company also announced manufacturing troubles at a key supplier's facility.

While subject to final product selection, food formulation, and consumer testing, Kellogg intends for the initial product launch to take place in mid-2006. "Kellogg Co. is exploring possibilities with Martek as part of our ongoing commitment to provide consumers with innovative products that provide a range of nutrition benefits," said Kellogg spokeswoman Kimberley Goode.

In mid-March, Martek reported that manufacturing troubles at a key supplier of arachidonic acid (ARA) had led to a shortage of the omega-six fatty acid that was responsible for lowered projected earnings for the second quarter of

its fiscal year. Martek's Chief Financial Officer Pete Buzy stated, "We do see a shortfall in revenue in the second quarter, but the long-term outlook for the company has never looked better," and added that the company is working on fixing its supply chain problems by the third quarter.

Nam Tai Electronics, Inc.

(NYSE: NTE)

VANCOUVER, CANADA – Nam Tai, an electronics manufacturing and design services provider to original equipment manufacturers of telecommunications and consumer electronic products, announced in late February that it has completed the construction of its new factory ahead of schedule. The new factory is adjacent to Nam Tai's main manufacturing campus in Shenzhen, People's Republic of China, and adds approximately 265,000 square feet to the existing manufacturing space. This expansion, combined with the recent relocation of its subsidiary J.I.C. Technology Company Limited to larger premises, has doubled Nam Tai's manufacturing capacity to approximately one million square feet.

With a Class 100 clean room, the new factory building is capable of housing the company's most advanced machinery and producing high-end electronic components and products. Nam Tai has commenced partial operations at the new factory and is expected to ramp up production to fully utilize the facility within three years, in accordance with the original timetable. "We are very excited to see the completion of the new factory ahead of schedule, which also marks a key milestone in our busi-

ness expansion and shows our long-term commitment to the high-end electronics industry," said Joseph Li, Chief Executive Officer of Nam Tai. "With a larger manufacturing space, we will be able to install more advanced machinery and to manufacture more sophisticated electronic components and products for our customers, enabling us to keep abreast of the rapid growth in the coming years."

Quantum Fuel Systems Technologies Worldwide, Inc.

(NASDAQ: QTWW)

IRVINE, CA – Quantum and Starcraft Corp. announced in early March they have successfully completed the combination of the two companies, after shareholders of both companies approved it at special meetings of their shareholders. Under the terms of the merger agreement, Starcraft shareholders will receive 2.341 shares of Quantum common stock in exchange for each share of Starcraft stock that they hold.

Going forward, Starcraft will be operated as a wholly owned subsidiary of Quantum. "We are excited to start leveraging the synergies that we believe will result in a full service company with tremendous capabilities from concept to production, which ultimately benefit our customers," said Alan Niedzwiecki, Quantum's President and Chief Executive Officer. Jeff Beitzel, Starcraft's former co-CEO and Quantum's new Chief Operating Officer, stated, "We believe this merger will strengthen our position as a leader in the specialty vehicle design and assembly industry, especially for hydrogen-based applications."

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chicken; vegetarians can find tofu products; and epicurean cooks can locate herbs, ethnic foods, multigrain flours and other specialty ingredients often unavailable at their local supermarket. This is the genius of WFMI—the customer can feel both self-indulgent and virtuous. Similarly, investors in WFMI have good reason to feel rewarded – both financially and ethically. Not only does the company include environmental sustainability among its core values, but it can also point to solid growth.

From Small Beginnings

Founded in 1980 in an Austin, Texas garage, Whole Foods Markets is the brainchild of lifelong vegetarian John Mackey, who is currently the company's CEO and Chairman of the Board. Now the world's leading natural and organic foods supermarket, the company has grown into a 167-store empire. And as the U.S.'s first national certified organic grocer, WFMI has contributed significantly to the 20% increase in organic food sales per year over the last decade.

Coming full circle for its 25th anniversary, the company just opened its new Austin landmark store and world headquarters—an 80,000-square-foot pleasure palace located just blocks from the site of the company's first grocery store. According to the company, the new market "offers a mixture of food and theater unparalleled in the industry."

In addition to its commitment to quality for customers, WFMI is committed to quality for its other stakeholders. While the company has resisted efforts to unionize workers, WFMI has been



named to the Hall of Fame of *Fortune Magazine's* 100 Best Places to Work, having made the list for the past eight years. WFMI's board of directors is notably independent, including only one representative of the company, Mackey, and as reported in this issue's cover page article, recently moved to annual election of all directors.

A Commitment to Green Operations

If WFMI is about the pleasures of good, healthful eating, it is also about responsibility for the planet, linking its commitment to organic foods with its advocacy of environmental sustainability. Among steps to reduce the environmental impact of the food it sells, the company has:

- Removed genetically modified ingredients from its private-label brands
- Begun to establish more rigorous humane treatment standards for animals that are processed for meat
- Worked with the Marine Stewardship Council to improve sustainability in seafood production.

In addition to its food initiatives, Whole Foods has also incorporated waste reduction, recycling and reduced energy consumption into its operations, without adopting a formal environmental policy or management system. Cindy McCann, Vice President of Investor Relations, counters that while the company would "like to do better collecting data on environmental measures," the decentralized organization of the company doesn't lend itself to a universal policy. When environmental strategies are adopted, they are usually spontaneous efforts developed on a regional or even storewide basis, she explained.

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EDITOR-IN-CHIEF
Jackson W. Robinson

MANAGING EDITOR
Elizabeth R. Levy

CONTRIBUTORS
Diane Daly
David Kowal
Elizabeth R. Levy

Matt Patsky
Ellen Pfeifer
Jackson W. Robinson
Erica Schroeder

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and Design

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“Our team members want to do the right thing. Everyone is walking our talk.” Initiatives to reduce WFMI’s environmental footprint include:

- Reduction of energy consumption by 10% in 24 Mid-Atlantic stores through a wind energy program
- Involvement with community composting programs in several cities
- Creation of regional recycling programs at distribution centers
- Installation of a solar lighting system in the Berkeley store – a first for a U.S. food retailer
- Construction of the Las Vegas store with green and sustainable materials
- Design of the Sarasota store according to standards set by LEED (Leadership in Energy and Environmental Design) Green Building Rating System)

Sustainability and the Bottom Line

With its emphasis on organic products and environmental sustainability, Whole Foods is not the cheapest place to shop for groceries. And one of the criticisms company leaders often encounter is that WFMI’s core values could negatively impact profitability. In an interview with *Grist Magazine*, John Mackey noted, “I think one of the most

misunderstood things about business in America is that people are either doing things for altruistic reasons or they are greedy and selfish, just after profit... The whole idea is to do both. We don’t think there is a contrast between sustainable or ethical issues and bottom-line issues. For us, our most important stakeholder is not our stockholders, it is our customers. We’re in the business to serve the needs and desires of our core customer base.”

That said, the company boasted sales of \$3.9 billion in fiscal 2004, an increase of 23% over 2003, while net income for 2004 increased 31% to \$129.5 million. Investors have also been rewarded; for example, an investor who had held a share of WFMI since January 1, 2001, the last time the company was featured in *Winslow Environmental News*, would have seen the value of that investment rise by over 335%, as of March 1, 2005.

Whole Foods continues to remain a one-stop-shop for both consumers and investors. For the future, the company’s Statement of Interdependence states that Whole Foods, “as a publicly traded company, intends to grow. We will grow at such a pace that our quality of work environment, Team Member productivity and excellence, customer satisfaction, and financial health continue to prosper.” □



Should you invest for
the **environment**
superior growth
or **both?**

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