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SFM.OQ - Q2 2026 Sprouts Farmers Market Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Hello, and welcome to Sprouts Farmers Market second quarter 2026 earnings conference call. (Operator Instructions) I would now like to hand the conference over to Susannah Livingston. You may begin.

Susannah Livingston - *Sprouts Farmers Market Inc - Vice President - Investor Relations and Treasury*

Thank you, and good afternoon, everyone. We are pleased you are joining Sprouts on our second quarter 2026 earnings call. Jack Sinclair, Chief Executive Officer; Curtis Valentine, Chief Financial Officer; and Nick Konat, President and Chief Operating Officer, are with me today.

The earnings release announcing our second quarter 2026 results, the webcast of this call and financial slides can be accessed through the Investor Relations section of our website at investors.sprouts.com. During this call, management may make certain forward-looking statements, including statements regarding our expectations for 2026 and beyond.

These statements involve several risks and uncertainties that could cause results to differ materially from those described in the forward-looking statements. For more information, please refer to the risk factors discussed in our SEC filings and the commentary on forward-looking statements at the end of our earnings release. Our remarks today include references to non-GAAP financial measures. Please see the tables in our earnings release for a reconciliation of our non-GAAP financial measures to the comparable GAAP figures.

With that, let me hand it over to Jack.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

Thanks, Susannah, and good afternoon, everyone. Our second quarter results were in line with our expectations, and the core elements of our strategy remain strong. New stores continue to perform well. Our differentiated and attribute-based assortment continues to resonate and our teams are moving with urgency to sharpen value, improve communication and support customers in the areas that matter most.

The consumer environment remained challenging, with customers continuing to make thoughtful choices around the healthy grocery spend, and we continue to face difficult year-on-year comparisons. With that said, our most difficult prior year comparisons are behind us and become more manageable as the year progresses.

We continue to see opportunities to improve our business in the short, medium and long term. The short term, we are taking a balanced approach, investing to strengthen support for customers today while building capabilities to support our proposition for the long term, ensuring sustainable growth into the future.

In a moment, Curtis will review our second quarter results and our updated outlook. After that, I'll come back to discuss the key business priorities we are advancing across affordability, loyalty and personalization, innovation, real estate, supply chain and our teams.

Curtis?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Thanks, Jack, and good afternoon, everyone. In the second quarter, our results played out in line with our outlook as we continue to lap outsized growth from the prior year and help our customers navigate the affordability challenges that they face in the current environment.

Total sales were $2.3 billion, up $105 million or 5% compared to the same period last year. This growth was driven by strong new store performance, partially offset by a 1% decline in comparable store sales. We saw sequential comp improvement through May.

June, as expected, we had our lowest comp of the quarter as we lapped strong last year produce performance and the disruption in the natural and organic supply chain that sent more customers to our stores.

Starting in July, the business has improved in line with expectations. The sequential improvement has been driven by modest improvements in both traffic and units in the basket. E-commerce sales grew more than 12% and represented approximately 16% of total quarterly sales. Sprouts brand also continued to perform better than the rest of the business, representing 26% of total sales.

Our second quarter gross margin was 38.7%, a decrease of 12 basis points compared to the same period last year. This primarily reflects our loyalty investment and elevated fuel costs. These headwinds were partially offset by benefits from self-distribution and vendor participation to help support customer value.

SG&A for the quarter totaled $683 million, an increase of $38 million and 30 basis points deleverage compared to the same period last year. This was primarily driven by fixed cost deleverage from lower comparable store sales and investments in the business, partially offset by disciplined cost management and lower incentive compensation.

Depreciation and amortization, excluding depreciation included in the cost of sales, was $43 million. For the second quarter, our earnings before interest and taxes were $174 million. Interest income was approximately $68,000 and our effective tax rate was 26%. Net income was $129 million and diluted earnings per share were $1.37, an increase of 1% compared to the same period last year.

Turning to unit growth. We opened seven new stores, ending the quarter with 490 stores across 25 states. Our pipeline remains robust with more than 110 executed leases and 155 approved new stores, giving us confidence in our ability to continue expanding access to Sprouts over the long term.

Our balance sheet and cash generation remains strong and provide flexibility. Year-to-date, we have generated $369 million in operating cash flow, which enabled self-funding of our investments in capital expenditures of $186 million, net of landlord reimbursement. Through the second quarter, we also returned $210 million to our shareholders by repurchasing 2.8 million shares and have $626 million remaining under our $1 billion share repurchase authorization.

We ended the second quarter with $224 million in cash and cash equivalents and $22 million of outstanding letters of credit. As we look to the balance of 2026, we are beginning to move past the most difficult compares and seeing early progress, though the operating environment remains uneven.

We believe our initiatives in affordability, innovation, personalization, marketing and supply chain will strengthen engagement over time. Customer behavior is evolving gradually, and we recognize it will take time for our actions to fully gain traction in this macro environment. The lower engaged customer remains an opportunity, and all customers are managing units in the basket.

Given that context, we continue to take a disciplined view of the back half while investing in the actions we believe will support engagement and long-term growth. As a reminder, 2026 will be a 53-week year, with the extra week falling at the end of the fourth quarter.

For the full year, on a 52-week basis, our outlook for total sales growth is between 5.5% to 6.5%, with comp sales between negative 0.5% to positive 0.5%. We now plan to open 42 net new stores in 2026. This accounts for 43 new openings as well as closure of an underperforming store with an expiring lease.

Earnings before interest and taxes is expected to be between $675 million and $685 million. We expect our corporate tax rate to be approximately 25.5%, and we expect capital expenditures net of landlord reimbursements to be approximately $310 million.

Our diluted earnings per share outlook is expected to be between $5.32 and $5.40, assuming at least $300 million in share repurchases. This updated outlook also reflects the current consumer backdrop, our continued efforts around affordability, ongoing fuel surcharges and disciplined cost management. It also incorporates the expected one-time year-over-year gross margin benefit in the fourth quarter as we cycle an easier shrink comparison and the loyalty program changes we made earlier this year.

We believe this outlook gives us the flexibility to continue investing in customer value while managing the business with discipline. For the third quarter, we expect comp sales to be in the range of negative 0.5% to positive 1.5%, and diluted earnings per share to be between $1.20 and $1.24. EBIT margin pressure is expected to be approximately 50 basis points due to fixed cost deleverage from lower comp sales and the impact of more new store openings when compared to the third quarter last year.

And with that, I'll turn it back to Jack.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

Thanks, Curtis. Against an uneven near-term backdrop, we remain focused on the areas we can control, sharpening value, strengthening foraging, improving how we engage with customers and providing them a great in-store experience, advancing supply chain capabilities and executing against a strong new store pipeline.

We're using data to better support our customers on their health journey. Our customers care about what they eat, and we are committed to making healthy, clean food, more affordable and accessible, which is particularly important during these challenging times. Our teams are proud to rise to this challenge.

That commitment is directly connected to our top priority, serving our target customer. They continue to value the Sprouts experience, the quality of our assortment and the discovery we bring to health and wellness while also looking for practical ways to make healthy living fit their budgets.

We are responding in a way that is consistent with who we are by bringing together innovation, quality and targeted value in the areas that matter most. In the second quarter, our fresh deli meals, vitamin sale and $9.99 wellness bowls were examples of how this approach resonated with customers. Our first half affordability test produced mixed results.

Most actions drove better unit movement, while broader traffic response developed more gradually than expected. We're using those learnings to refine our second half approach, focusing on the items that matter most to customers and where targeted price and affordability actions can have the greatest impact on engagement.

Forging and innovation remain key strengths, and they continue to outperform overall company growth. They help differentiate the assortment and focus our space, promotions and new item activity around the products customers value most. During the second quarter, we launched approximately 1,300 new items, with an emphasis on attributes that we believe matters to our customers, including organic, seed oil-free, fiber, gut health and protein solutions.

These products help reinforce why customers choose Sprouts. With our exclusive partnership, Pasture bird chicken is now available nationwide at Sprouts and products like Better Pop and Bitte Soursop Shots are resonating with customers.

Our organic offerings continue to gain traction across departments, now representing more than 30% of total sales, including more than half of sales in dairy and produce. Loyalty and personalization remain important long-term enablers for the business as consumer behavior evolves against this uneven macroeconomic backdrop, we continue to see progress. Our acceleration efforts have identified new tactics to drive sales that should benefit us in the second half. And the data we are building is increasingly useful across the business with more in-depth customer behavior and preferences.

Building our first-party data capability will continue to support our long-term strategy by unlocking value for our customers and Sprouts across the enterprise. Marketing is one area where our new data can help us more effectively engage customers in the second half of the year and beyond.

We're using these insights to better target media across both existing and new customers while also refreshing our creative to more clearly communicate Sprouts' unique position and bring the brand to life. We'll continue to tailor our messaging to highlight health, discovery, the unique products that distinguish Sprouts and compelling value on the healthy essentials our customers need.

Our supply chain work is also advancing. Our Northern California distribution center is open and operating smoothly, and nearly 85% of our stores are now supported with fresh meat through Sprouts distribution centers. This gives us greater control over our freshness, service levels and shrink, and the financial benefits from this transition will continue to support our efforts on affordability.

We also are continuing to advance our self-distribution journey with targeted investments in our existing space, beginning with select Sprouts brand SKUs as we look beyond produce and meat to the next phase of this work. New stores remain one of the clearest proof points of the strength of our model.

Performance continues to be strong, and our teams are selecting great sites, opening stores efficiently and bringing Sprouts to more communities. We are pleased with the progress across both high-volume existing markets and newer markets that are continuing to build awareness and momentum.

Our construction teams have done a great job improving our processes and shortening our time to build stores. Given these improvements, along with our strong pipeline, we will be opening 42 net new stores this year, slightly ahead of our original guidance. We will open at least 15 stores in the third quarter, which represents our largest quarterly opening cadence to date.

Lastly, the Sprouts team remains the heart of the organization. Our team members bring the Sprouts experience to life every day from the quality and freshness in our stores to the service and education they provide our customers. Their commitment to our purpose, our team and our customers remains a key advantage for our business.

In summary, we are operating with discipline against a dynamic near-term backdrop while staying focused on the actions that strengthen engagement, reinforce the Sprouts value proposition and position the business for sustainable growth. We appreciate your continued interest in Sprouts and look forward to keeping you updated on our progress in the quarters to come.

And with that, I'd like to turn over for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ed Kelly, Wells Fargo.

Edward Kelly - *Wells Fargo Securities LLC - Senior Analyst*

Hi. good morning. Good afternoon, everyone. Could we maybe just start with comp cadence? And I'm specifically interested in July. You talked about July being in line. Could you provide a little bit more color around the month versus the Q3 guide? The Q3 guide leaves the possibility of a negative component. I'm not sure if you saw that in July? And was there any impact from Cyclospora? And then just remind us of the compares by month moving forward now.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Sure. Yeah. Ed, this is Curtis. Lots in that. So comp cadence sequentially improved through May, as we said in the script, June was a tough month. That was really the end of kind of the challenging LY compares last year in June, really strong produce season, disruption to the natural and organic supply chain that sent customers our way. And so those are behind us now.

As far as the second half of the year, there were no major disruptions or benefits last year that we're up against. So the comp will sequentially get easier from a comparison perspective month-to-month as we go forward.

Within July, we're within our guidance range, just slightly negative for July is where we landed. And then on Cyclospora, it's really live right now. It's been really the last two weeks where we've seen a bit of impact on the business. And so we really just kind of deal with that in real time. I mean, first and foremost, food safety is our number one priority. The team really does a great job with that.

They're watching all the news and the regulatory updates closely. And we haven't had any product recall impact in our stores to date. But it's impacting the customers and how they shop. It's really isolated to kind of lettuce, salads and salad-related items is where we've seen a bit of an impact. So it's a shift in from fresh to frozen.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

So we're watching this pretty closely, just to see where it's going to go, the customer reaction to this. It's difficult to know exactly how this is going to play out, but we're focused on food safety.

Edward Kelly - *Wells Fargo Securities LLC - Senior Analyst*

Okay. And maybe just a quick follow-up, Jack. You mentioned affordability results of the effort kind of being mixed and maybe some adjustments that you're making. Could you talk a bit more about that? And are those adjustments meaning like intensifying pricing effort? Is it just sort of like how you're spending the dollars?

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

We're being very focused on trying to look after our customers on those items that matter most. And the tests that we've done, as we said, have been mixed and different departments have done -- different items have performed differently.

And the challenge for us is making sure that everything we're doing fits in within the model that we're working on. So I'll maybe let Nick. Nick and his team have been doing a lot of work analyzing the specific detail of what we're investing in. And I think we've got a pretty good handle on what it's going to cost and what we're going to do going forward.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Yeah. Ed, kind of three-pillar approach to the affordability work we outlined. The one that I think is showing the most growth and really happy with what the team is doing is in our assortment efforts. So we see really strong momentum in our healthy meal solutions, and we're continuing to increase that offering with the health-driven attribute-driven meals. We talked about our new $29.99 family meals.

We now have all of our fresh-made salads in store under $9. So that's been really strong for us. The second lever of that assortment has been in Sprouts brand with innovation in the healthy essentials. So I'll give you a couple of examples. We're launching seed oil-free frozen potatoes that are now a top seller in the category.

We're just about to launch a $4 -- actually we did just launch a $4 fresh baked organic sourdough bread. So you see us investing in the areas that's important for our customer and the assortment. On the price and promotion piece, as Jack mentioned, it's been a little tougher to move the customer in this environment.

We are seeing good basket and unit velocities from some of the price and promotion efforts we're doing, but we're continuing to test and learn both how we price and also how we message. And we're going to continue to be prudent about how we do that as we learn how to move the customer.

And then the third pillar of that work is in personal and loyalty and our personalization efforts and the acceleration of the learnings we've had in the first half of the year and the third quarter to help continue to move our existing customer.

Edward Kelly - *Wells Fargo Securities LLC - Senior Analyst*

Great. Thanks, guys.

Operator

Leah Jordan, Goldman Sachs.

Leah Jordan - *Goldman Sachs Group Inc - Analyst*

Good afternoon. Thank you for taking my questions. I just wanted to follow up on Ed's first question around the comp. So in the prepared remarks, you talked about July improved in line with your expectation, but you still narrowed the comp guidance for the year.

So I'm just trying to get a sense of what's making you may be less optimistic in terms of getting to that top end now. Is it really around the macro increasing competition? Or is it simply just, hey, we've had a softer start to July and maybe some of this is tied to the lettuce concern that you talked about. Any color there? And then just ultimately, maybe frame your confidence on getting back on to algo by the fourth quarter. Thank you.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

Yeah. I think the questions are with regarding to getting back to algorithm, we're feeling pretty confident about our guidance going forward in terms of what we're projecting. In terms of the specifics, there's a macro environment that's kind of difficult to really put your handle on.

Clearly, grocery prices are going up. Gas prices have gone up and down, and they're clearly putting pressure on. And we can see it in the units, and it's not -- across grocery units are not as strong as they were because of the inflation.

So we're trying to second guess exactly where this is going to play out. But our guidance is something that we feel pretty confident about. And certainly, if the comparisons that we've got going forward play out the way we expect them to do, we should be back on our algorithm in due course.

Leah Jordan - *Goldman Sachs Group Inc - Analyst*

Okay. That's helpful. Maybe just a quick follow-up on that. We'll stick with the comp here. I mean just maybe more color on the drivers, how you're thinking about traffic versus units versus AUR kind of as we move through the back half. It sounded like traffic and units were getting better in July. Just trying to think about the underlying drivers for your comp outlook as we go through the fourth quarter.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Yeah. I think we expect sequential improvement in traffic for sure. Yes, units and traffic should get better. It's not going to come from AUR. Traffic was the thing that went up really well when we were doing well and has been moderated and been the driver as we've softened here. So I think we'd expect that to continue to get better as the compares get easier, and then units should get a little bit better as we continue to work on the affordability piece.

Thomas Palmer - *JPMorgan Chase & Co - Analyst*

Okay. Thank you.

Leah Jordan - *Goldman Sachs Group Inc - Analyst*

Thanks, Leah.

Operator

Tom Palmer, JPMorgan.

Thomas Palmer - *JPMorgan Chase & Co - Analyst*

Hey, good afternoon, and thanks for the questions. Maybe I could just first clarify on the guidance revision. So comps were narrowed around the midpoint. The second quarter earnings came in a little bit ahead of, I think, what you'd guided for.

So I just wanted to understand maybe some of the narrowing to kind of the bottom half when we look at that EBIT outlook, if there are maybe incremental investments that are contemplated. I know there was the reference to some deleverage. And so maybe the extra couple of stores is the difference, but anything else on top of that? Thanks.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Tom, it's Curtis. Yeah, I mean, really, the EBIT midpoint to midpoint, $5 million change is really fuel. We're just looking -- as we spoke about last time, we covered it off in Q2. But we said we didn't have it covered in the second half, and we weren't -- we're going to wait and see how that played out. Obviously, it remains elevated and it has been pretty volatile. So we're embedding $2.5 million a quarter in the second half for fuel.

Thomas Palmer - *JPMorgan Chase & Co - Analyst*

Great. Thanks for that. And I also wanted to ask on some of the, I guess, vendor participation that was noted and then in one of the earlier answers, you noted focus on accelerating personalization. With the loyalty rollout, are you starting to drive increased support? I think that's one of the goals and the belief was it might take a little bit of time working with vendors. But I am curious if we're hitting a point where that's becoming more of a factor, just given the call-outs earlier.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, Tom, it's Nick. I would say we're still early stages in that. I mean we just started opening up vendor participation in the program at the beginning of this year. And so we're nascent in that. And the idea is always, hey, you have these really unique vendors with unique customers, with unique needs, and how do you tie them all together to help them find their audience in their market because we have the health enthusiasts that a lot of these new brands want.

And so I think -- I feel really good about that strategy. We're starting to see more and more vendors participate and see benefit from participating in the program. So we're certainly ramping, but it's early stages. And I think we've got certainly -- as we build out the capability, as we continue to invest in technology, that will be something we continue to push over the next number of years.

Thomas Palmer - *JPMorgan Chase & Co - Analyst*

Got it. Thank you.

Operator

Kelly Bania, BMO Capital Markets.

Kelly Bania - *Bank of Montreal - Analyst*

Hi. Thanks. Thanks for taking our question. I wanted to just double-click on the comment about kind of all customers are managing units per basket. As we look at your sales across the two categories between perishables and nonperishables, it looks relatively stable.

So just wondering what is really happening underneath the hood there with units per basket. I thought that was a little bit more isolated to produce, but maybe you can just help us understand if anything has changed on the units per basket and what the plan is there to address that. It sounded like the focus is on traffic for now. But just as you look out further on the units per basket, what is the remedy for that?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Kelly, it's Curtis. I think units in the basket, produce is always a lead because it's one of the larger -- it's the largest unit count in our average basket. But we -- in these times, we saw it back in '22 and '23. And again, here, when the prices are up or there's an inflationary environment or the customer is under pressure, for us, they tend to manage that last item in the basket. And so it's a little bit of an impact across the entire business and then produce usually has a little bit larger impact just simply because there's more produce units in our basket, say, than the average conventional.

And so as far as what we're doing, I mean, I think the things that we are doing from a loyalty and personalization perspective, certainly, that should help on the unit front. And from an affordability perspective, that will help on the unit front. And we're seeing some good progress on units in the tests that we're doing, as we alluded to earlier, we'd like to see a little bit of a broader impact from a traffic perspective, but the unit piece has been positive so far.

Kelly Bania - *Bank of Montreal - Analyst*

Okay. And Curtis, when you talk about kind of thinking about the items that matter most to your customers, some of the examples, I think, sounded like they were in fresh. Maybe correct me if I'm wrong, but are you -- how do you think about kind of balancing the fresh kind of price investments or affordability versus kind of the new innovation and the new items, which seems so critical to the Sprouts merchandising strategy? How do you balance that? Or are you trying to figure out where to put more or less investment between those categories?

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, Kelly, I'll take that. It's Nick. We start with our customer and less -- think about it less around fresh and nonperishables and more around what's in the customer's basket and what's most important for them. And for us, I think you've heard me talk about the healthy essentials. It's organic cheese, it's organic bread, it's organic meat and it's obviously organic produce.

So it's across the board on these nonperishable and perishable that we're focused on, and then looking at what's most important to them and where can we help make some of these things more accessible to them. And that's where you see us both innovating with assortment and especially in Sprouts brand and then making the selective investments to ensure that they're more accessible.

So we look at it from a total customer standpoint, and we've seen good success in fresh right now because I think that's a good driver for the customer around meals and meal solutions, but look at it holistically across the store.

Kelly Bania - *Bank of Montreal - Analyst*

Thank you.

Operator

John Heinbockel, Guggenheim.

John Heinbockel - *Guggenheim Securities LLC - Equity Analyst*

Hey, can you guys address cohort performance demographically, right? I'm thinking -- you've talked in the past about the emerging health enthusiast, right, perhaps having more affordability issues. So how is that group performing?

And then when you distinguish between, right, so you had some waves of shelf price reductions and then you've also done some stuff with the loyalty program in 3x, 5x points. When you think about what's working, what's not working from a pricing standpoint, how would you assess that?

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, John, it's Nick. I think the broader headline -- the two headlines for me on the question of working and not, I think one is the macro is tough, and it's tough. The customer is proving tougher to move overall. So efforts are not quite the same as they may have been in a more stable market. We don't have the level of inflation that we're seeing in the market.

So that has an impact overall. And I think the second thing is we're seeing, as we mentioned before, our less engaged, lower income customer is the one that's been harder for us to move. Some of that's a lapping story, John.

We're obviously still lapping some of that. But if you look at our cohorts and our loyalty customers, it's those that are a little less engaged, lower income where it's been tougher to drive that trip and that extra item in the basket.

John Heinbockel - *Guggenheim Securities LLC - Equity Analyst*

Maybe as a follow-up to that, I know the other opportunity, right, because of the sheer amount of product introductions, is to reach out to folks, right, that are attribute oriented to let them know the 1,300 items came in and maybe that's the opportunity is bigger with higher income customers. But to what degree are you doing that now? Or is that still to come, right, where there's these prompts calls to action about these items?

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Yeah. We're definitely doing that. We're seeing it in the numbers. Our innovation, the products that we are -- the new products we've launched in the last year are significantly outperforming the overall box. We're seeing the innovation continue to be strong and the customer continue to be willing to buy the new items, the unique items they see with us.

So I think that's a combination of the forging work that we continue to do, the strong pipeline and innovation that our merchants and forging team has built. And then we are continuing to introduce it to our customers, not just through loyalty, which has been personalization, but also through social media and our marketing. And so I'm actually very happy with how our newness continues to perform. We certainly have aspiration to continue to drive it even further, but that's been good for us.

John Heinbockel - *Guggenheim Securities LLC - Equity Analyst*

Thank you.

Operator

Krisztina Katai, Deutsche Bank.

Krisztina Katai - *Deutsche Bank AG - Analyst*

Hi. Good afternoon, and thanks for taking my questions. So I wanted to follow up on the affordability test. You've noted that you're seeing improving unit movement, but it's generating a slower-than-expected traffic response. So can you help us quantify the gap there? And you call these tests having mixed results. What have you learned about elasticity and this overall customer response that is shaping your second half investments?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Krisztina, it's Curtis. I don't -- I won't -- and Nick or Jack may jump in as well, but I don't think I'll get too specific on quantifying the exact expectations there or what's -- where we've been. I'll just say, I think the one thing -- again, go back to its challenging to move the customer in this environment. And the longer we've gone with the elevated fuel and the challenging macro, it's just a little bit harder.

Things that worked last year aren't working as well this year, things that we think should work that we try don't work quite as well. And so there's been a lot of learning and kind of readjusting to the current environment for how we go to market. And that's really kind of how it's playing out as we think about the tests, whether it's in personalization or whether it's in price and promotion.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

And I think one of the -- the macro challenge is one of the biggest things that I think is affecting the ability for us to move traffic. And the comparison to last year is pretty significant on some of the things that happened last year. And those lower engaged customers that came to us last year in some unique circumstances, that's the one -- that's the group that we're seeing the biggest challenge on growing the traffic. But when that lapping rolls off, we're feeling pretty confident about that linking to all the work that Nick's team are doing in terms of how do you give value to the customer and how do you give value on those items that matter most to the customer. We're seeing some progress on that. I think the traffic will take a little bit longer.

Krisztina Katai - *Deutsche Bank AG - Analyst*

That's helpful. And if I could just follow up on that. Obviously, you called out the lower engaged customer remains the largest opportunity. So if you could just sort of give us any framework around how to think about that? Just how much of the comp pressure today is coming from these shoppers?

What percentage of your customer base would you characterize as lower engaged today? And if you could just maybe tie that in terms of what behavioral changes are you seeing as the loyalty and personalization efforts gain traction? Thank you.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, Krisztina, it's Nick. I probably won't quantify it, but I would tell you that where we're seeing the biggest challenges, as I mentioned in John's question, was with the lower engaged customer. It's certainly a smaller portion of our spend and a smaller portion of our customer base. So it's not our core customer, but we certainly see that. And the behavior your question was about is we're just seeing them spread the trips out a bit more.

We're not seeing them take the same low frequency maybe as they have in the past. I think that's what's driven by in the macro, right, and that people are managing their wallet right now and what they can spend. So that's kind of what we're seeing from the less engaged cohort.

And the good news is our core customer has remained pretty resilient. I think part of what we're seeing in some of the price activity, it's been good for units in the basket, a little bit tougher on traffic, but we're seeing the customer respond to a great assortment that's at a great value and some of the newness and things that we've launched. I think that kind of highlights the type of customer we have and who we really stay focused on as we continue to work in the second half.

Krisztina Katai - *Deutsche Bank AG - Analyst*

Okay. That's great color. Thanks. Best of luck.

Operator

Rupesh Parikh, Oppenheimer & Company.

Rupesh Parikh - *Oppenheimer & Co Inc - Analyst*

Good afternoon. Thanks for taking my questions. Just given a number of players highlighting price investments out there, just curious how you guys feel about your price gaps and just overall, what you're seeing on the competitive promotional front? Thank you.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

Specifics in terms of price gap, we talked fairly consistently, Rupesh, about that in terms of the important pricing and the way we've got direct comparisons with other guys is in our produce. So we continue to pay a lot of attention on our produce. We're very pleased with where we are on our organic produce, and it's a fairly volatile market as you -- as we alluded to earlier. So produce pricing, we feel we're in a pretty good place in terms of relative to the competition in that space.

And with regard to other activities that are going on in the marketplace, and clearly, a lot of people are talking about things that are going on in the marketplace. We are pretty confident that the assortment and products we're putting together are differentiated enough, that we have to focus on the value of those items that matter most to our customers, and our customers being that health enthusiast customer.

And as Nick alluded to earlier, just picking the right items at the right price is something we can do because our products are differentiated, and we do that in the context of making sure we've got the right value for the customer going forward. And that's been our pricing model for a long time now.

Rupesh Parikh - *Oppenheimer & Co Inc - Analyst*

Great. And then my follow-up question, just on new stores. Commentary suggests that they're still performing really well. But just curious, just given the more difficult backdrop, have you guys seen any challenges in how these stores ramp or anything else to highlight just given the weaker backdrop?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Rupesh, it's Curtis. No, actually, that's one of the things we're really pleased about and kind of continues to give us confidence in the go-forward and in the strategy overall, is the new stores continue to open well. And it's really across the country. We've opened them in New York and in Florida and across the California. And so new stores open everywhere.

They're all generally performing the way we'd like them to. We see the typical nuances of new markets versus more established markets, but all of them kind of performing ahead of our expectations and in line with the last couple of years of performance.

And then the other encouraging proof point is the recent vintages are comping positive. So as the core is a bit challenged, those last four vintages are all positive. And again, just continues to point to this is an offer, this is a format, this is a model that the customer is looking for. So I've been really pleased with the new stores.

Rupesh Parikh - *Oppenheimer & Co Inc - Analyst*

Great. Thank you.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Thanks.

Operator

Mark Carden, UBS.

Mark Carden - *UBS AG - Analyst*

Good afternoon. Thanks so much for taking the questions. So this one -- this builds on the last one a bit. It sounds like you're seeing good momentum on your new stores. As you look to your stores in newer markets, is your customer mix mirroring what you see across the broader footprint? Is it any tougher to bring in customers that are closer to the lower end of income spectrum in markets where you're still building up your name recognition? Does the excitement of the new concept offset this? Just what are you seeing on that front? Thanks.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Yeah. Mark, this is Curtis. I think it's -- in newer markets, it's just challenging generally because the awareness isn't there. And that's really the big difference. I don't think it's any materially different from a cohort perspective.

We watch mix and what they shop from a department perspective. There's no dramatic differences there. I just think it takes a minute for people to figure out who we are, figure out that we're different and how they can incorporate us into their share of wallet from a grocery perspective. And so those stores, as we talked about over the years, tend to build a little bit slower -- or sorry, build a little faster. They start a little bit lower and then they build a little bit faster as customers figure us out.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

And it's definitely clear, when you go to Long Island, we're not as well-known as when we open stores in Los Angeles. So we see that very specifically in our numbers. But the mix of our customer base, I don't think it's significantly different from where we are everywhere.

Mark Carden - *UBS AG - Analyst*

Great. That makes sense. And then you guys alluded to some other opportunities from a self-distribution perspective. How would you think about timing as to when it's right to in-source additional categories? Does your experience with meat and seafood pull up the timeline at all there?

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, Mark, it's Nick. We're really happy with the work the supply chain teams have done and the merchants have done in completing the meat rollout that we wrapped up with our NorCal DC in Q2. They've done a phenomenal job across the board. And I think what it's proven to us is, hey, there's potential for us to continue to learn and look for more ways to control the key products that are really important to us and our customer.

And as Jack mentioned, we're starting to dip our toe in the water a little bit there with some -- a couple of Sprouts brand items that we're bringing in, using the capacity we have in our existing distribution centers to, again, take ownership and try to improve service levels and profitability in the business.

We're going to continue to take it one step at a time, learn, see how that's working and assess, but we're going to continue to look for ways we can take more control where it makes sense for us, but we're taking a measured approach over the next couple of years, and we'll look at that as we look at our long-term plan on our network as well.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

And we're investing appropriately in supply chain. We've built, I think it's four distribution centers in the last few years, and we've got more to come going forward in terms of building capacity to support our store base as we grow into different marketplaces.

So it's been a strong evolution of our supply chain over the last few years, and this idea of getting more control over things like Sprouts brand and some of the core categories is going to be really important to us, and we're investing in it appropriately.

Mark Carden - *UBS AG - Analyst*

Great. Thanks so much. Good luck, guys.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

Thanks, Mark.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Thanks.

Operator

Scott Marks, Jefferies.

Scott Marks - *Jefferies LLC - Equity Analyst*

Hey, good afternoon, guys. Thanks very much for taking our questions. I wanted to just hit on a comment you made in the prepared remarks about EBIT margin pressure being about 50 bps in Q3. I think you called out a few different components of that with more new store openings, fixed cost deleverage, lower comp sales. You called out some of the fuel headwinds. So just wondering if you can kind of help us bucket each of those components in terms of contribution from each as it relates to that expected pressure. Thanks.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Scott, it's Curtis. I think probably the easiest way to say it is it will be pretty similar to what we experienced in Q2. So if you go up and down the P&L in Q2, the shape of it is going to look pretty similar. So slightly negative gross margins, slightly negative SG&A, a little bit of pressure in D&A, and then the new stores piece really kind of folds into that SG&A pressure.

Scott Marks - *Jefferies LLC - Equity Analyst*

Okay. Clear on that. Thank you. And then previously, you had also called out a cannibalization factor in existing markets where you're rolling out new stores. Wondering if you can just give us an update on that and what you're seeing now relative to what you had been seeing previously? And that's all. Thank you.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Thanks. Scott, Curtis again. Yeah, I think we talked about 100 to 150 is kind of the range we typically expect to see, and that will depend on mix of new versus existing markets and et cetera, et cetera. Right now, we're towards the lower end of the range.

One piece is we've -- a fewer store openings in the first half, and we'll ramp that up here in the second half. But through Q2, it's kind of towards the low end of that range, and that's slightly better than what it was last year, but we've been pretty consistently in that range.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

I think one of the things that's encouraging for us is that the calculations on cannibalization, the model, the guys are doing a really good job at predicting exactly what that cannibalization is so we can really understand it. We've got much better at that over the last few years.

Operator

Scott Mushkin, R5 Capital.

Scott Mushkin - *R5 Capital LLC - Equity Analyst*

Hey, guys. Thanks for taking my questions. So I wanted to go back to the pricing thing for a second because we've seen some interesting pricing at you guys -- with you guys. And the example I would give is where we see FAGE yogurt priced very well, but then we see Rao's tomato sauce priced way above the market. And I guess I was just curious like how deep do you guys get in understanding where the market is on different items to make sure you're priced right, or maybe there's times you can actually come up a little bit.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

We will dig into the specifics of those points, Scott, which we'll dig into understanding exactly where they are. We are looking on brands like that to where other people are pricing at. And it's a combination of are we -- what's happening in the category? Are we evolving the category or not, which is how important is that category for us. And I think we'll get better at that approach going forward. Maybe you want to say something.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

No, I think Jack said it. The only thing I would add, Scott, you know us. I think as we look at it, our intent is to try to continue to bring in brands that don't have the level of competition in a couple of those categories. We have a lot of new innovation coming in there, too, that we're trying to introduce people to and get into that space.

But for the most part, again, the goal is to continue to try to not carry the same things. And when we do, be everyday competitive. And there's certainly opportunities for us to tighten execution, but that's the way we're looking at the business, and that's the way we're executing.

Scott Mushkin - *R5 Capital LLC - Equity Analyst*

And that goes right into -- execution goes right into my second question, is that you guys are opening a lot of stores now. How are you thinking about -- I remember Whole Foods back in the day when they were opening so many stores, one of the bigger challenges was just getting the right store manager in there, making sure the execution was consistent across the fleet.

And again, one of the things they ran into is when they poached people out of stores, the execution at the older stores could fall down a little bit. So how are you guys thinking about this as growth has really accelerated?

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

I'll let Nick go through a bit of detail on that. It's a really good question, and we're thinking very hard as we grow our store base, how do we develop this. And the whole process of promoting internally has been an important part of our exercise, and we're really pleased with the assistant manager programs that we're making progress on.

Going forward, as we get to 40, 50 stores going forward in the years ahead, this is an important and a really important part of our proposition to the customer. And we call ourselves Sprouties, and making sure we create and grow Sprouties is a key part. And our HR team are doing a terrific job working with the ops team. Nick, I don't know whether you want to build. It's such an important point.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Yeah. I'll just give a little more color to Jack's comments, Scott. I think this has been something we've been talking about for a while, super important to build our pipeline. It starts with making sure our culture and values are really well ingrained across the business. That's what drives the experience that's unique for us in the stores and done a lot of great work there.

We've put a lot of time into actually recruiting and bringing people internally before we place them in stores and letting them work side-by-side with assistant managers and managers to increase the pipeline of people who are ready.

And we're continuing to invest in putting more ASMs and store managers in the stores early to help us get people ready to take on a new store. And to your point, make sure that the existing stores maintain. I think we're really happy with what we're seeing in the new stores. The teams have been great. And overall, I've been impressed with what I've seen in the existing, but it's certainly something we'll continue to invest in that pipeline as we continue to grow the number of stores.

Scott Mushkin - *R5 Capital LLC - Equity Analyst*

Okay. Thanks so much. Appreciate the answers.

Operator

Robert Ohmes, Bank of America.

Robert Ohmes - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

Hello. Hey, guys. A couple of quick follow-ups for you. The first is just I'd love to get your sense of like-for-like inflation and maybe the trends that you saw in the first half. And as we go into the back half, what does inflation look like? Is it accelerating into the back half? And is it coming through from suppliers and things like that?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Robert, it's Curtis. The first half is -- second quarter was pretty consistent with the first quarter. We're seeing on like-for-like SKUs, inflation in line with CPI. And then for us, we always have a little bit of a mix uptick in some of our newer products and maybe more premium innovation driving the AUR up a bit. But on a like-for-like basis, we're still fairly in line with CPI. And then you've got just a handful of categories like coffee and beef that are elevated.

Robert Ohmes - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

That's helpful. And then there's been some commentary out there and maybe some data, I don't have it, but about, I guess, the West Coast being much weaker, at least for the traditional grocers than, say, the middle of the country in the East Coast. Can you remind us your exposure to the West Coast? And have you seen significant differences in West Coast versus other regions?

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

We've got a lot of stores in the West Coast. And quite honestly, Robert, we're not seeing any difference in our performance in the West as we see in the rest of the country. But we've clearly heard that from others.

Robert Ohmes - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

That's great. And just I'm going to slip in one last one. When you go to Long Island and when you think about opening up Hartsdale and Boston and places like that, do you -- are these higher average store volume markets in general for you? Or you would not expect that?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Robert, it's Curtis. I think we have high hopes and aspirations for those markets. I think they're going to be strong markets for us. I would think, though, that early days, what we typically see when we open a new market, is the volume is a little bit lower. Again, it takes a minute for people to figure us out.

We don't have great density. That's challenging for marketing, just scale of the business. And so early days, we expect them to be a little bit lighter than our average opening, and then we expect them to ramp pretty quickly over time. And certainly, one of the big changes we've made as we think ahead to Chicago and even greater New York is getting to that density even quicker. And so I think in Chicago, you'll see us start in 2027.

And then our expectation is 12 to 18 months later, we'll have 10 stores in Chicago, and there'll be a good presence of Sprouts in Chicago. And then we're putting our foundation teams and our marketing teams on the ground early in those markets to really build community and let folks know we're coming. So we're trying to get ahead of that in those newer markets. But that said, I think we'll still expect them to start a little bit slower.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

And they are denser markets. So ultimately, they'll be great stores once you get the awareness where it needs to be --

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Robert Ohmes - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

Thanks. Great. Thank you.

Operator

Michael Montani, Evercore ISI.

Michael Montani - *Evercore Inc - Analyst*

Great. Thanks. Good afternoon. Thanks for taking my question. Just wanted to ask, first off, on the lettuce impact. We were thinking about an [80 bp to 120 bp] range impact currently that might moderate to like 30 bps to 50 bps for the quarter. I'm wondering if you could give any commentary around if that's consistent with what you're seeing in your expectation set. And then the follow-up I had was around initiatives that you've got in place that give you confidence that you can drive comp units and stabilize traffic.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Yeah. Hi, Mike, it's Curtis. On the first one, again, that -- it's really live, right? It's been the last two weeks where we've seen the impact there. And so we're really watching it closely. As far as what's going to happen, I mean, I don't think we've got a great handle on that. We'll have to just watch it, monitor it closely and see how it plays out. So it's been a small impact thus far over the last two weeks, and we'll be watching it closely.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, Mike, it's Nick. I'll answer the second part of your question. I think some of that I talked about, if you think about how do we continue to drive the comps in the second half with the assortment work around meals and healthy essentials and the innovation there. I think we're still -- it's still a lot of testing and learning in price and promo. And then obviously, personal and loyalty, I think we've got some good green shoots in that space that leads to momentum in the second half.

And then the other thing I hadn't mentioned, I've been really happy with what I'm seeing from Mandy, our new Chief Customer Officer, and her team on the marketing front as we look at new ways to harness her capabilities and insights on media, on using our first-party data, that we're now acquiring in an even stronger way outside of our ecosystem.

And also, you're going to see us, I think, get even better about our messaging and communication on how we balance health, innovation, quality and value. So I like the work I'm seeing from the team that the customers will start to see in the back half of the year.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Hey, Mike, it's Curtis again. I'll just clarify that -- as far as the quarter-to-date piece of it or what's behind us, the number you quoted was just a little bit high versus what we're seeing. I won't speculate about what will be going forward, but it's not quite as high as you had it for the last couple of weeks that we've seen.

Operator

Seth Sigman, Barclays.

Seth Sigman - *Barclays Services Corp - Analyst*

Hey, everyone. Thanks for taking my questions. I wanted to focus on e-commerce. Growth accelerated this quarter. It was actually a big driver, I think, of the overall comp improvement despite that channel seemingly becoming more competitive.

So just with the new data that you have on customers, is there anything more you can share about what you're learning about that customer? Where are they coming from? How do they shop across channels? How valuable are they? Thank you.

Nicholas Konat - *Sprouts Farmers Market Inc - President and Chief Operating Officer*

Hey, Seth, it's Nick. Yeah, I'll share a couple of things. And it's pretty similar to what we've seen. But you're right, we saw very good e-commerce growth, and it's been a really good partnership with our partners, Instacart, DoorDash and Uber Eats. I think what -- the reason we continue to see it even in a bit of a challenged macro, is we have a lot of things that customers really want and need that they can't find anywhere else.

And even now, right, when maybe they might not be making -- getting the car to make that trip, they can get something ordered online or just have it picked up in front of our store, and we're seeing both our delivery and pickup businesses perform well.

The e-commerce customer for us is an omni customer. For the most part, the vast majority of those customers shop both channels, and they're our highest value customers. So the more we grow that customer in business, that's a very good thing for us.

And as we mentioned in the past, I think what we're seeing is the basket for e-com and the mix look pretty similar to what you see in brick-and-mortar, high amount of produce, a lot of fresh. I think the customer trusts our fresh business, and that's why you see it coming through in e-commerce. So a pretty consistent dynamic to what you'd see from a mix standpoint in brick-and-mortar.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

And Seth, I'd just add, this is Curtis. It's another really good proof point for the model at large. I mean we've talked about new stores and innovation and those continuing to perform. This is another area that's continued to perform in a macro environment where you'd expect to be some pressure on it.

And so again, it just highlights that the assortment is something the customer is looking for and when we can -- we want to be wherever they need us to be to service them, and e-com is a great channel for us, and we expect it to continue to grow going forward.

Seth Sigman - *Barclays Services Corp - Analyst*

Okay. Thank you for that. That's super helpful. And then I just want to follow up on the margins. So the expectation that gross margin will be down slightly in Q3. I think the hope was that second half would see gross margins flat to up slightly. I think that was the original expectation. So is the delta there just higher fuel? And if you could just clarify if there's any assumption that price would help offset that? Like how are you thinking about that?

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Yeah. I think really, yeah, the slight difference from the prior commentary is the fuel piece, which does land in gross, and that's a challenge. And I think the answer to the second part of the question is like that's not the right time for us to be pushing through price where the customer is and where the macro is and with the work we're doing on affordability. And so the fuel piece is an incremental pressure we didn't have contemplated when the year began, and we're dealing with it accordingly.

I think within Q3, specifically, there'll be just a little bit of an impact from the Cyclospora piece as well, and that's probably the Q3 story, a little bit of fuel, a little bit of Cyclospora. And then in the fourth quarter, we've got fuel embedded in where we're going.

And then we do expect the fourth quarter margin to be up slightly. Again, the onetime changes in the loyalty program. So we'll be -- the $2 going to $1 started in January. So the fourth quarter will be a full run rate last year at the $2 level versus the $1 this year. So there'll be a little bit of a onetime benefit there.

Seth Sigman - *Barclays Services Corp - Analyst*

Okay. Thanks so much.

Curtis Valentine - *Sprouts Farmers Market Inc - Chief Financial Officer*

Thanks, Seth.

Operator

Thank you. Ladies and gentlemen, I'm showing no further questions in the queue. I would now like to turn the call back over to Jack Sinclair for closing remarks.

Jack Sinclair - *Sprouts Farmers Market Inc - Chief Executive Officer, Director*

Well, thanks again for your attention. We appreciate you taking the time to listen to our quarter call, and we look forward to updating you in the future. Take care, everyone. Thank you.

Operator

That concludes today's conference call. Thank you for your participation. You may now disconnect.
