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SFM.OQ - Q3 2026 Sprouts Farmers Market Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to Sprouts Farmers Market third-quarter 2026 earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker for today, Susannah Livingston. Please go ahead.

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 third quarter 2026 earnings call. Nick Konat, President, Chief Operating Officer and incoming Chief Executive Officer; Curtis Valentine, Chief Financial Officer; and Jack Sinclair, outgoing Chief Executive Officer, are with me today.

The earnings release announcing our third 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.

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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. Before we get into the quarter and an update on our business. I am looking forward to working with Sprouts in a different capacity as Executive Chairman. It has been the opportunity of a lifetime to be the CEO of Sprouts. We have grown the business, strengthened our competitive position and built a more resilient organization. I'm especially proud of the culture behind that progress and the thousands of team members who bring our purpose to life every day.

I feel very good about entrusting Sprouts next chapter to Nick. He knows our company, our customers and our opportunities well. The Board and I have great confidence in him, the broader leadership team and the long-term potential of Sprouts.

We recognize that our recent performance needs to improve. While the consumer environment and the Cyclospora disruption affected the quarter, we also have work to do to strengthen our execution and customer proposition. In a few moments, Nick will outline the actions we are taking and the investments needed to support stronger performance.

For now, I will turn it over to Curtis, who will discuss results and our updated outlook. Curtis?

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

Thanks, Jack, and good afternoon, everyone. Before I review the quarter, I want to thank Jack for his leadership of Sprouts and for the partnership over the years. I'm looking forward to working with him in his new role.

For the third quarter, after seeing progress in our sales trajectory through July, comparable sales softened in August and September and did not improve as comparisons eased. Total sales were $2.3 billion, up $104 million or 5% compared to the same period last year. This growth was driven by strong new store performance, partially offset by a 0.9% decline in comparable store sales.

The comp results reflect the Cyclospora disruption, which reduced comparable store sales by approximately 60 basis points during the quarter. The decline was driven by a 3.3% decrease in comp transactions, partially offset by a 2.5% increase in comp basket. These factors inform both our revised outlook and the investments we will discuss.

New stores remain a key proof point around the overall potential of our model. Our 2026 vintage is outperforming our expectations and our recent vintages are comping positively, reinforcing our confidence in the long-term unit growth opportunity.

E-commerce was another bright spot in the quarter, with sales growing 12% and representing more than 16% of total sales. This month, we also expanded our e-commerce reach with the launch of Shipt, our fourth platform. Sprouts brand also continued to outpace national brands in our stores and represented approximately 26% of sales. Both of these growth drivers benefit from our differentiated assortment and products customers often cannot find elsewhere.

Gross margin for the third quarter was 38.2%, a decrease of 50 basis points compared to the same period last year. This primarily reflected higher shrink due to lower sales and the Cyclospora disruption, as well as higher fuel costs. These pressures were partially offset by the benefits from self-distribution.

SG&A for the quarter totaled $683 million, an increase of $30 million and a decrease of 10 basis points as a percentage of sales compared to the same period last year. This was primarily driven by fixed cost deleverage from lower comparable store sales, partially offset by lower

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incentive compensation compared to the last year. We continue to pursue opportunities across the short, medium and long term to manage costs effectively while supporting our strategic priorities.

Depreciation and amortization, excluding depreciation included in the cost of sales, was $45 million. For the third quarter, our earnings before interest and taxes were $153 million. Interest expense was approximately $1 million, and our effective tax rate was 25%. Net income was $113 million and diluted earnings per share were $1.21, down 1% compared to the same period last year.

Turning to unit growth, we opened 15 new stores, representing our largest quarterly opening cadence. We also closed 1 underperforming store at lease expiration, resulting in 504 stores across 25 states at the end of the quarter. Year-to-date, Sprouts has opened 27 net new stores. Our pipeline remains strong with more than 105 executed leases and over 160 approved new stores. We continue to expect 42 net new stores in 2026.

Our balance sheet and cash generation continue to provide flexibility. Year-to-date we have generated $555 million in operating cash flow and invested $275 million in capital expenditures net of landlord reimbursement. We returned $299 million to our shareholders through the third quarter by repurchasing 3.9 million shares and have $537 million remaining on our $1 billion share repurchase authorization.

Based on current activity, we now expect full year share repurchases to exceed $300 million. We ended the quarter with $229 million in cash and cash equivalents and $22 million of outstanding letters of credit.

Turning to our outlook, recent trends support a more measured view for the remainder of the year. Traffic units and frequency are not recovering, even against easier compares that began late in the third quarter. This was an important signal that the pressure on the business was not cyclical and that a more meaningful response is required.

Our revised outlook reflects those recent trends and the actions we are taking to increase and accelerate investments to improve affordability and to strengthen the long-term health of the business. We are listening to our customer, and we need to respond now to help them live and eat better in a challenging backdrop.

As a reminder, 2026 is 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, we now expect total sales growth of approximately 4.3% and comparable store sales of approximately negative 1.7%. We continue to expect to open 42 net new stores.

Earnings before interest and taxes are expected to be approximately $605 million. We expect our corporate tax rate to be approximately 25% and capital expenditures net of landlord reimbursements to be approximately $310 million. Diluted earnings per share are expected to be approximately $4.80, assuming more than $300 million in share repurchases.

For the fourth quarter, we expect comparable store sales to be between negative 2% to negative 4%, and diluted earnings per share to be between $0.47 and $0.51. This includes gross margin deleverage of approximately 90 basis points driven by deeper investments in affordability and SG&A deleverage of approximately 170 basis points driven by fixed cost deleverage due to lower-than-expected comps and higher store labor and benefits costs.

Our full year outlook is presented on a 52-week basis. We now expect the additional 53rd week to contribute approximately $190 million of sales, $20 million in EBIT and $0.16 of diluted earnings per share. As Nick will discuss more in a moment, we know our challenges and are taking significant actions to address our performance for the long term.

These actions include investments in affordability, technology and supply chain. While we plan for near-term margin pressure as we reset the business for long-term growth, we expect EBIT margins to remain above 5%. From there, we remain committed to using the self-help opportunities we've previously discussed to rebuild our margin profile over time. Over the next several months, we will assess customer response and refine the scale and pace of our investments accordingly.

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And with that, let me hand it over to Nick.

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

Thank you, Curtis. And Jack, thank you for your leadership, your partnership and your commitment to Sprouts. I look forward to continuing working together in our new capacities.

For the past four years, I have had the opportunity to help shape and execute our strategy. That experience has given me a deep understanding of what makes Sprouts distinctive, where we need to improve and how much potential remains ahead of us.

We operate in the health and wellness market with a target customer who is focused on healthy, fresh and innovative ways to meet their nutrition needs. These customers remain an attractive and growing segment of the US food-at-home market with an estimated market opportunity of more than $290 billion.

We have a unique position in the market. Our curated assortment and product innovation continue to differentiate Sprouts. Strong recent store openings across established and newer markets reinforce the appeal of our proposition, while our strong store pipeline and smaller format model provide a long runway for disciplined growth. These strengths give us confidence in our model.

At the same time, our recent performance is not where it needs to be. We understand why. We are taking actions to improve it. Competition is intensifying. Affordability is a bigger driver of choice and the target customers' needs are constantly evolving.

Sprouts must evolve faster as well. Our level of innovation, investment and execution must rise to meet the customer and market opportunity in front of us. Our customers continue to tell us they love Sprouts, particularly our shopping experience and the differentiated products that help meet their individual needs. At the same time, they're looking for us to make healthy eating more affordable to help them meet their evolving nutrition and health goals.

That is the larger opportunity for Sprouts to become an even more relevant and trusted partner, leveraging our strengths with innovative products, practical meal and health solutions and greater value, giving them more reasons to shop with us.

As I step into the CEO role, we have more work to do, but our immediate priorities are clear, improving comparable sales and customer traffic. We are already taking actions that will affect the fourth quarter and shape our plan for 2027.

Today we need to do more to support our customers and strengthen the Sprouts proposition to be more accessible and affordable. Our efforts to date have not been enough, and our current pricing strategy has not delivered against that goal. This means making more meaningful price investments across a broader range of products.

To that end, we are rebuilding our pricing strategy, and we'll roll it out nationally in January, when Sprouts is most top of mind for healthy solutions. This is not a shift to broad-based discounting or an effort to compete on price alone. Our objective is to offer more compelling value within our differentiated proposition by offering a greater role for Sprouts brand, innovative products across price points, value on healthy essentials, convenient meal solutions, and a personalized experience to help customers discover and save.

We have seen encouraging customer response to assortment innovations such as wellness goals, price below $10, $29.99 family meals for four, and fresh baked organic sourdough for $4. These are examples of how Sprouts can combine differentiation, quality, convenience and value in ways meaningful to our customers.

We need to build that response and go further. For the holidays, we are going to be reducing prices on healthy and holiday staples across the country, a deeper investment on the key items most important to our customer and what drives them into stores.

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Supply chain will remain a significant self-help lever to drive profitability. Greater control over freshness, service levels, inventory and shrink will help us respond faster to changes in demand and improve execution over time. We are now planning the next phase of self-distribution with a selection of Sprouts brand products representing a logical next step as we look to expand the benefits of our network.

Technology will also be another critical enabler. Modernizing our systems and selectively applying AI will help us connect data across the business, move faster and scale more efficiently. The growing amount of first-party data captured through loyalty will deepen our understanding of customers while giving our marketing teams better insights into reaching prospective customers who most resemble our loyal shoppers.

We recognize these investments will affect our near-term margins. Our immediate priority is to strengthen the customer proposition and support healthier traffic and sales. Over time, we believe stronger sales performance, together with expanded self-distribution, improved retail media, vendor partnership, sourcing initiatives and continued cost savings can help us rebuild profitability and create long-term shareholder value.

As we look ahead to 2027 and beyond, we have three jobs to do, all grounded in serving our customers better and giving them more reasons to choose Sprouts. First is to grow our reach. We will continue opening high-quality new stores and expanding e-commerce, bringing Sprouts to more customers and making it easier for them to find the unique items they need.

Second is strengthening our model. We need to accelerate the differentiation that brings customers to Sprouts and make healthy eating more affordable. That means increasing the pace and impact of innovation, investing where value matters most, and improving freshness and availability, all while preserving the distinctive experience our customers value. We are also evaluating opportunities to refresh the experience in our stores and make our products and solutions easier to discover.

And third, build what's next. We have the potential to become a stronger partner in our customers' health journeys. Our forging team will keep Sprouts at the forefront for their health and wellness needs, partnering with emerging brands early in their journey in developing practical solutions, their evolving priorities through our Sprouts brand. Connecting that differentiated assortment with deeper customer insights and more personalized engagement will help us deliver practical solutions that are relevant and easy to discover.

In addition, our culture will remain a fundamental differentiator in how we win. Our approachable, knowledgeable team members and their personal connections with customers are central to what makes Sprouts distinctive.

As we grow, we will continue to strengthen that culture, both in the experience we deliver to customers and in the opportunities we create for team members to learn, grow and build careers. That commitment underpins the freshness, service and consistent executions customers experience in every store.

In summary, we are clear on our direction, put the customer at the center, extend our differentiation, improve affordability and build the capabilities to unlock value for our customer and our business. We are clear on our priorities and are moving with urgency, while continuing to refine our longer-term plans. Sprouts has a differentiated model, a large and growing customer segment, compelling unit growth, and a great team and culture that's hard to replicate. This gives me confidence in our next chapter and our ability to create long-term value for our customers, team members and shareholders.

Now I will turn the call back to Jack.

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

Thanks, Nick. Before we close, I want to thank our team members across the company. The progress we have made in helping people live and eat better is a tribute to the thousands of team members who show up every day committed to our purpose, our customers and each other. My greatest privilege has been working alongside this team and watching what can be accomplished when we work together.

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As Executive Chairman, I'm aligned with Nick and the leadership team on the challenges we need to solve and the actions we are taking. These changes are required to meet the needs of our customer. We will be working closely over the next few months on our short and long-term actions that will reposition Sprouts for future growth.

And with that, we would like to turn it over for questions to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Seth Sigman, Barclays.

Seth Sigman - *Barclays Services Corp - Analyst*

Hey, everyone. Thanks for taking my question. A few key questions here. So when we look at the fourth quarter guidance and the implications beyond, it's a really big change in margins versus what was implied before. It looks like a 100 basis point swing at least on the gross margin. I understand the urgency. But what gives you confidence to make such an aggressive change now? Maybe if you could speak to the testing, the case studies that you've seen that give you confidence to make the big changes in the investments that you're speaking to here in the fourth quarter. Thank you.

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

Yes, Seth. It's Nick. We've been paying very close attention to what's going with our customer. And as we look at what's happening in business right now, as I mentioned in the call, we are focused right now on getting our customer back in our stores and driving sales and transactions. And as we look at what we've seen from the customer, both in what they tell us and how they respond through their wallet, affordability is the key current issue we need to address and solve.

We -- they made it clear to us that what we are doing isn't far enough. We have confidence in what we're doing, because a lot of the things we did early in the year have shown promise. Like I mentioned, we've been invested in innovation with health and value together. We've seen the customer respond. But it wasn't deep enough or broad enough to move the customer and move transactions as we need.

And so rather than wait over a longer period of time, we're acting with conviction now because we believe in the long-term health of the model. We're not going to let the customer fade away from us. We're going to make moves to get them here and to get the business back on track and recognize the potential of the long-term model with a healthy customer, strong market, great performance in new stores and additional growth.

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

And Seth, this is Curtis. I'd just add, I mean, the other part of Q4 is shrink is not where we want it to be right now either. So we expected that to be a tailwind, and it's continuing to be a challenge. So from a year-over-year perspective, again, shrink isn't where we want it to be. And then obviously, we've got the fuel challenge that continues to be elevated. So a couple of other pieces within the fourth quarter. But again, we feel to take bold action now to take care of the customer and keep moving forward with that.

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Seth Sigman - *Barclays Services Corp - Analyst*

Okay. That's helpful. Look, I guess the message is that this is not a one quarter dynamic. So some of these investments are going to wrap into next year. Can you give us some perspective today on what the total level of investment should look like from a gross margin perspective? I guess the concern would be that your gross margins are still significantly above where a lot of other folks in the industry are today. And so where does that need to get reset to?

And then -- and just the last piece related to that, maybe you could speak to the ways that you can fund that, whether it's through media or vendor funding or supply chain. How should we be thinking about those as potential offsets to these investments? Thank you.

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

Yes. Seth, it's Curtis again. Yes, so when we put the kind of the 5% in there to help understand what the level could be, obviously, we're going to take dramatic action here with the gross margin bit and get the affordability investments and the next wave of those going in the very near term and short term. What we'll watch closely is the customer responds to that. And that will help us pace the timing and the depth from a gross margin perspective.

As you highlighted, we have lots of self-help opportunities, we talked about over several quarters now and the things that we'll be landing here in 2027 and beyond. And so self-distribution, the retail media, the opportunity with the data from the loyalty program and vendor partnership there, all opportunities all still in front of us to go unlock value in the P&L and create some offset to the affordability investment. Again, what we need to understand now is how is the customer is going to respond to this next wave, and that will give us a lot of clarity into February and into 2027 guidance.

Seth Sigman - *Barclays Services Corp - Analyst*

Thank you, both.

Operator

(Operator Instructions)

Rupesh Parikh, Oppenheimer.

Rupesh Parikh - *Oppenheimer & Co Inc - Analyst*

Good afternoon and thanks for taking my question. So first, I guess, on unit growth as we look to FY27 and beyond, just given some of the challenges in the core business, how does your team think about potentially slowing unit growth to maybe improve or stabilize profitability even faster?

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

Rupesh, it's Curtis. Yes, I mean, clearly, we're going to have to think about that as we look ahead. It's going to be a strong part of our story going forward. We continue to be pleased with the new stores as they've opened well, they're comping in their year two, three for the last few vintages. So it's a high-return vehicle for us. But we've got to balance that with the other needs of the business. And we need to balance our investment portfolio to address traffic in the core store challenges. But we do believe new stores is going to continue to be a strong opportunity for us.

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Rupesh Parikh - *Oppenheimer & Co Inc - Analyst*

Great. And then my follow-up question, just on traffic. So as you look at some of the new efforts that you're doing, are you seeing any green shoots or just your overall confidence you have in actually being able to improve traffic with the new efforts underway?

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

Yes, Nick. We are. What we've seen is some of our efforts that we've made across either pricing affordability investments or affordability investments in the product side have seen some fruit. As I mentioned in the previous question, it just hasn't been enough to move enough traffic to our stores. We've seen really good category response and item response, but it hasn't been broad enough or deep enough to do so.

And that's what gives me confidence that the investment we're making in some of the things that are most important to our customers that builds trust, that provides access to key health categories and the items that hear about most is going to continue to drive traffic.

I also go back to what I said in the call, we've seen good results with e-commerce. We've seen strong results with our new stores. And so we know the model and the proposition is very strong. Our customers tell us that. So you'll see us continue to lean into that.

And then we still have a lot of areas where we can continue to focus on how we win. Our innovation is growing in our stores. The areas where we've innovated continues to show strong growth. As I mentioned, we've got really good marks on our store experience, and that will continue to be a key area. E-commerce, Sprouts brand and then the continued development of loyalty and personalization all give me a lot of confidence in our ability to continue to grow.

Rupesh Parikh - *Oppenheimer & Co Inc - Analyst*

Great. Thank you for all the color.

Operator

John Heinbockel, Guggenheim.

John Heinbockel - *Guggenheim - Analyst*

Nick, to start off, can you -- when you think about breadth and depth of -- you didn't go deep enough or broad enough, which I'm not sure both are equally an opportunity, but where do you see, which one is more important? And then I know the unengaged member or the unengaged customer was not responding. Have you seen weakness spread to the more engaged customer?

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

Yes, thanks, John. I think as we look at the -- what we've learned and also what we're looking at as we rebuild our pricing strategy, I think I'd kind of put it into three buckets when I think about breadth. Number one is there's an opportunity for us to provide more affordable entry points in the categories. So think about that as really a place where Sprouts brand can play, things like cage-free eggs or and in areas where we haven't been as affordable entering in new -- some key categories for us.

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The second part of the breadth on the strategy is around trust builders, those kind of higher frequency, more competitive items. Think, in our case, like conventional produce. I think we've got room to be much sharper there. We've done a great job on organic, but that's an area where I see a lot of opportunity for us.

And then the third bucket around breadth is the -- as I -- we're calling the target customer KPIs. These are the items that drive customer choice in their healthy options and selections, Think of these as things like organic grass-fed beef. And that's where I look at the breadth and where we're pointing our pricing strategy. The depth will just depend more, John, on market, and we're going to make sure that we're right by market and be more focused there. Some we're in a good place and some we have more work to do.

The second question on the customer. You're right, the less engaged customer has been the biggest driver of our traffic decline and footsteps into the store. But to your point, we have started to see it a little bit more with our core customer. They're still stronger, but we've seen a little bit of softening in behavior, which was one of the key indicators for me and for us that we need to take action now.

John Heinbockel - *Guggenheim - Analyst*

And then my follow-up real quick, when you think about the spread, right, between new store productivity, has remained very, very good, the comps have softened, how do you assess that, that increasing spread between the two. Usually, they kind of track together at least a little bit.

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

Yes, John, it's Curtis. It's unique. I think it's not what you would expect to see. And that's -- again, the new stores have continued to perform well, and we're seeing good response when we open new stores. And so on the one side, that's positive for us, that the new stores are performing the way that they are, and we haven't seen as much of a challenge in the new store portfolio. It's the core stores that we've got to do a better job with, and the things that Nick spoke about there and what we're getting after here in the very short term we're really addressing that core store challenge to improve the comps.

John Heinbockel - *Guggenheim - Analyst*

Thank you.

Operator

Thomas Palmer, JPMorgan.

Thomas Palmer - *JPMorgan Chase & Co. - Analyst*

Hey, guys. Thanks for the question. Curtis, if I heard you right, you noted that you expect EBIT margin to remain above 5%. The 4Q outlook, obviously, implies something quite a bit lower. I'm just trying to think about, maybe the progression of EBIT margin. Should we be thinking about 4Q is kind of the low point for margins and then you return to this 5% plus? Just any color there given that 5% comment?

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

Yes. Q4 is always our kind of lowest quarter from that perspective. We're typically -- we've got the full weight of the new store vintage out there. It's a lower sales quarter for us. January is our Super Bowl, as we say, and that's our fresh start to the new year. And so we see our

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strongest sales in January. And we're a little bit softer usually in the holidays where we're less top of mind maybe for customers. And so that's a typical kind of historical phenomenon.

And then within that, you've got some of those unique challenges. Last year, we saw the business slowing in the fourth quarter and we took some action, pulled forward some changes from a labor perspective, accelerated some of the investments in that space to try and manage it. As we talked about throughout the quarter, we can kind of work our way through a few quarters at those lower comps, but the longer you go, the more challenging that gets.

And so we got our new stores opening up, we've got our investments landing, and the comp just simply isn't where we need it to be. So I don't expect that to be indicative of the shape of Q1 or where we're headed. It's a little bit more of a 2026 Q4 phenomenon.

And as I just mentioned a couple of questions ago, shrink is not where we want it to be either. That is higher than it should be. Some of that is the sales and some of that is we got to continue to a better job managing our inventory and our SKUs and in and out and all those things. So a few different kind of Q4 '26 specific type phenomenon, not particularly indicative of where Q1 or Q2 or Q3.

Thomas Palmer - *JPMorgan Chase & Co. - Analyst*

Thank you for that. Okay. One more follow-up, I guess, on kind of this 4Q versus 2027 dynamic. There was the reference to some planned actions really coming in January, but also mention of some deeper investments as we think about the holidays. So presumably kind of November, December. Is that like the experiment time where you kind of over-invest in price and see what sticks, and that's where January you start to institute more permanent changes? I mean, what's really, I guess, in mind for this nearer term versus what comes in January?

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

Yes, Tom, a couple of things. So first off, as we have mentioned, we're rebuilding a pricing strategy, and we're putting some of those elements into market now, to help us kind of learn to be prepared for January overall. So we're rebuilding now with the input or the belief or the plan, excuse me, to launch in Jan. So we are doing things in market right now to test and learn.

And the other thing I mentioned is we are making action now on items that we know right now drive transactions for our customer on the healthy holiday essentials that matter most. These are areas that we can go deeper right now where a customer needs it for the holidays and to help drive more traffic into the store.

As Curtis noted, January is our -- is kind of our win time. That's when we're most top of mind for our customers. And so that's why we wanted to go national with the strategy with all the noise in the holidays in November, December. We're using this to get ourselves ready to take care of the customer in Jan, but at the same time making moves right now to serve them within the things they need most over the holidays.

Thomas Palmer - *JPMorgan Chase & Co. - Analyst*

Understood. Thank you.

Operator

Mark Carden, UBS.

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Mark Cadren - *UBS AG - Analyst*

Thanks so much for taking our question. So I wanted to start with a follow-up on shopper behavior by customer type. It sounds like it's starting to impact your core customer a bit as well. When you think about it from an income cohort perspective, are you seeing pressure across the board? Or has it been more isolated to call it the lower third? In other words, are headwinds starting to creep up even the income chain?

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

Hey, Mark, so what we're seeing -- what hasn't changed at all is that the less engaged customers is still where we're seeing the biggest leakage. So that's been the case. And within that customer set, there is a -- it's a larger impact with slightly lower income. So we are seeing that.

What's changed recently is we've seen a little bit more of an impact on our core customer, slightly fewer units in the basket, a little bit of softening on the trip side. And we see it generally across the board. It's not strictly based on income level, but we're seeing it overall with that customer, which is, as I mentioned earlier, why I just said that we need to make a change and make a move now to take care of the customer and get the margin set up to allow us to do that.

Mark Cadren - *UBS AG - Analyst*

Great. Thanks. And then on competition, you talked about it accelerating in the space. Are you seeing it both at natural organic focused retailers as well as the conventional players? Do you think more customers are shifting their natural organic spend over to mass and conventional just because of where prices are at, even if it's not necessarily something they prefer to do? And how do you think about best approach for advertising your new strategy and making sure they're aware of what you guys are able to do on that front?

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

Yes. I think there's three factors in this that I think all play together. We are seeing competition across a number of channels, continue to chase the health of the customer, which we think validates the opportunity in the space that we believe in the long term. So we're not surprised by that. We are seeing it happen.

As we've talked about, affordability is a challenge for the customers in this space. And then the third piece is the macro is not helping, right? I think that's only exacerbating, making it tougher for us, making it tougher for the customers. So those three things together, I think, are what's impacting the customer.

From a competitive standpoint, I'm not surprised that they're continuing to play more in the space. I think it's, overall, we're seeing customers migrate to value channels, which is another indicator that affordability is a key opportunity for us. But I feel really good about our ability to win and compete in this environment because our whole model is built to serve the needs of this unique customer, not just about the items that some of the other people will carry.

So as I look at our core competencies of innovating, a really fantastic store experience, those are our strongest muscles, and we need to flex them faster and stronger to serve the customer where they are now. And I know we can do that to help offset any competitive challenges. And as I mentioned right now, invest in affordability to help the customer mood that is a barrier to come to stores.

Mark Cadren - *UBS AG - Analyst*

Appreciate all the color. Thanks so much. Good luck, guys.

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Operator

Kelly Bania of BMO Capital Markets.

Kelly Bania - *Bank of Montreal - Analyst*

Hi, thanks for taking the question. Also I just wanted to go back to gross margin here, and two questions. I guess as you look at the fourth quarter, I think you said 90 basis points of deleverage. How much price is in that because you mentioned shrink, fuel, I'm guessing some sales deleverage impact, so just trying to understand how much price is in the fourth quarter?

And this comment that you are committed to maintaining EBIT margins above 5%, I mean, how can you commit to that? Where do we -- where do gross margins -- where do you think gross margins can settle out here?

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

Hy, Kelly, it's Curtis. Yes, the gross margin will go maybe in reverse order. I mean certainly, that 5% creates a lot of space between where we are today and that mark. So it gives us a lot of room to assess the things that we're going to go do. We're going to make some investments in the gross margin. I think the lion's share of the P&L impact will come through gross margin and that affordability investment, the technology and the supply chain activity, a little bit of SG&A, but a lot of capital in that space. And that's -- some of that's already kind of built into the model and the way we think about capital going forward.

So those are things that we're going to go after and we'll see what the customer response is. Obviously, we're talking about traffic being a priority and traffic first and repairing that with the customer, and then we go from there. So the investments we'll make here between the holiday activity and the January pricing, and then we'll see how the customer responds.

And then all those self-help levers we have over time become optionality for us to continue to go further if we need to. So we feel like we've got some space now to do what we need to do. We'll see how the customer responds and we'll again adjust the pace and the scale accordingly.

Kelly Bania - *Bank of Montreal - Analyst*

And when you see how the customer responds, are you targeting any specific price gap to competition? Or do you just kind of monitor it and say, once traffic kind of stabilizes, that's how we'll see how the customer responds, if things start to stabilize? Or do you have a specific price gap in mind?

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

Hey, Kelly, it's Nick. We do have a more competitive position how we're looking at the strategy and by market and by category, but most importantly, by the things that are most valued by our customer on the gaps we want to have. I think if you look at it, we were at more of an item elasticity model in the past, and we're shifting to a customer and solution model across the products.

As I mentioned, I think, in John's question around the areas of focus for investment around entry points, trust builders and our key items for target customers, that you'll see us invest in. And then we'll measure it based on units, transactions in the store and the customers coming back to our site in store, and that's how we'll measure and they'll tell us when we're in the right spot.

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Operator

Krisztina Katai, Deutsche Bank.

Krisztina Katai - *Deutsche Bank AG - Analyst*

Hi, good afternoon and thanks for taking the question. So I wanted to follow up on the test, right? You've said a strong item and category responses, but did the stores where you tested these actions generate better total store transactions and frequency versus the control stores, just how much of the unit lift is incremental versus customers simply shifting purchases to the lower-priced items?

And then as you're thinking about the broader price investment, just how should we think about how broad that is in terms of what percentage of the assortment do you realistically need to touch for the consumer to really respond through increased trip frequency? Thank you.

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

Yes, Krisztina, it's Nick. If you think about your second question on where we'll look at it, I think as I've said, what we learned from the tests that we've run in the past is that we weren't brought enough in the number of items that we needed to focus on, and it wasn't broad enough to make an impact on the overall customer traffic to store.

We saw a movement within, again, item and category, but we didn't see enough to the customer, and the ability to tell the story and make sure they understood what we were doing to invest in them. And so that -- some of those learnings that we've captured is what's informed, as I've mentioned, a broader investment across the business.

As I mentioned earlier, there's a number of key areas around entry, trust and the key items for our core customer that we're investing in. It's a much more substantial part of our assortment than we've done in the past, which is why we reflected in the margin and the guidance we've had for you today.

Krisztina Katai - *Deutsche Bank AG - Analyst*

Got it. And then just as a follow-up, should we interpret the above 5% EBIT margin comment as a conservative 4%, so likely the trough? Or is that a reasonable planning range for 2027? And what level of comp rate would that also assume? Thank you, guys.

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

Yes. I think right now, Krisztina, I think, again, 5%, yes, we would hope that that would be the floor, and that's the idea. We've got the room now, but we've got to really assess this next wave of activities? And is it enough? And could it be better than that if the customer really responds? That's what we'd hope to see.

But we've got to put those things in market. We've got to work our way through the holidays and into the January time frame and see how the customer responds to that. And so we're not ready to guide for 2027 or speak to the comp as it relates. But that's the idea now, is we're investing now, we're going to see the customer response and then we'll have, obviously, a much more specific answer in February for guidance for '27 and beyond.

Krisztina Katai - *Deutsche Bank AG - Analyst*

Great. Best of luck.

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Operator

Robert Ohmes, Bank of America.

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

Hey, guys. Two quick follow-ups. I think my first question is just on -- what -- can you give any more color on marketing changes you might be making to drive traffic or maybe educate people out some of the pricing changes you're making?

And then the follow-up question would be ahead of time, which is just Cyclospora from here, what kind of a headwind is it to comps? Thanks.

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

Robbie, it's Nick. I'll take the first question and pass to Curtis. On the marketing changes side, as I mentioned, January is a key month for us, both for acquiring new customers and then traffic with existing customers. And so as we look at how do we go to market in January, the affordability investment and the pricing will be part of our go-to-market story and the marketing story we tell as we do so in Q1.

I think the other thing I would tell you on the marketing side is one thing that is really clear to me and you're going to hear a lot from me in the future is we have got to continue to understand our customer better, serve them better and run our business through them more. And so we are at a place where we can start to unlock more insight in the customer data we've been capturing and use that to drive not just the market, but even the merchandising and product development work we have.

And so that's an area that you'll see us use that will unlock media, unlock more retail media for us, unlock acquisition, and then certainly serve our innovation and forging work overall. That will be something that we take advantage of here as we begin 2027.

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

And then, Robbie, on the Cyclospora, we called out the 60 bps in the quarter. It kind of peaked for us in that August, early September time frame. It was a little bit higher than that, and it's gotten progressively a little bit better since. It's still a slight headwind as we sit here today quarter-to-date for the fourth quarter. But we are seeing it start to improve.

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

Thank you.

Operator

Scott Marks, Jefferies.

Scott Marks - *Jefferies LLC - Equity Analyst*

Hey, good afternoon. Thanks for taking our question. First thing I wanted to ask about, Nick, on the previous question. You started to touch on data a little bit. And I don't think we've heard as much recently about the loyalty program. So wondering if you can just update us with where you are on that, what kind of engagement you're seeing from the customer and maybe how you've been leveraging that to this point if you have?

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

Hey, Scott, so as I mentioned, overall, I mean the data is going to be a key unlock for us. We are about a year into the launch of the program. As I look at it, I think we've made progress, but it's not as far as we need to be. We've been talking about our -- the work we've invested in that program to drive customer value and customer behavior.

We've gotten -- we are now at a place we've got a good set of data and talent capabilities to then start to bring that into the organization in a bigger way. And we just barely cracked the surface of it, to be honest with you. That's why I'm excited about starting to do more of that moving forward, and understanding customer needs, understanding the key solutions and need states customers have.

Look at the business, the importance of item and attribute is significant, but where the customer is moving is into how to use those to solve key need states. So I talked about we're going to continue winning gluten-free, but we also need to own gut health because that's the solutions where people are going, and we can start to use our data to unlock that.

And so you'll see us do that. And I think it's important to remember that for us, our value proposition starts with a target customer with healthy, innovative, fresh, convenient solutions for our customer. And then the affordability piece is going to be the layer on that removes a barrier to enjoy and come back to Sprouts and the stores they love. And we'll continue to go to market in that same way.

Scott Marks - *Jefferies LLC - Equity Analyst*

Appreciate the thoughts there. And then maybe just secondly, you've highlighted a number of areas where you think you need to invest in affordability. Wondering if you can just help us understand, maybe as we look across departments within the store, maybe what departments have you seen that have been more challenged versus ones that have been maybe a bit less impacted by some of these affordability challenges? Thanks.

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

Yes. So a couple of things. I think let me start with what's relatively consistent across all categories, and that's where we are distinctive and innovative with where the customers' needs are, that's winning. And we're driving newness in those spaces, whether that be in frozen or in bakery and deli, innovation, newness around health, convenience, freshness and value is working across all categories.

I think where we've seen opportunities is in areas where we have maybe a little bit more overlap or similar overlap. We think about our produce business, to me is a key area of opportunity and focus. Our meat business is one where another area where we can continue to differentiate and win in that space, but I think we also -- that's where I look at meeting the customer where they are from an access and affordability standpoint is where we have a good amount of opportunity.

Operator

Greg Melich, Evercore.

Greg Malik - *Evercore Inc - Analyst*

Hi, thanks. I wanted to follow up on the e-commerce growth of 12%, now 16% of sales and adding Shipt under the platform. Can you maybe describe how that growth is accelerating and just what you're seeing in the baskets there? And when you think about the reset of margins, how you want to lean into e-commerce? Thanks, guys.

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

Yes, Greg, I'll start, this is Nick, on e-com. We've mentioned this in the past, but I do believe that's a really strong indicator of the strength of our proposition where we have these items that are harder to find in other places. And for customers who can't make the trip to the store, e-com is a really great opportunity for them. And it continues to be a growth driver, and I think a proof point of the strength of our model.

On the behavior itself, that basket is a bigger basket. That customer is an omnichannel customer. And as I mentioned in the call about the focus on grow, this is an area of a lot of opportunity for us. While it's 16% of our sales, it's still relatively low penetration on the number of our customers. And as people become more aware of what we can do in the e-commerce space, we provide more access with both our own channel and our partners. I think this is an area of continued growth because the customer tells us this is how they want to shop Sprouts when they can't make it to our store.

Greg Malik - *Evercore Inc - Analyst*

Got it. Thanks. And then a follow-up on -- you said the newer stores are just doing better. I guess when you look at those, is there something in the store that you're seeing in those that you can -- you're thinking about rolling out to the existing chain, maybe a few things that stand out?

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

Yes. I think part of the credit to the new stores, we've -- I think we've done a really great job with putting those very close to our target customers, and the teams in the stores have done an amazing job. As I mentioned in the call, I think there's an opportunity for us, and we're actually moving now on looking at some of our more legacy stores and core stores and looking at ways to refresh some of the experience there and bringing together, whether it's more merchandise in the categories that are working, improved ways to find and discover our innovation and our forging work improved ways to highlight freshness in the stores, I think that's an opportunity for us. And we're starting to work there and putting some tests in the market soon, to look at the fleet and the existing fleet and ensure we keep up with what we're seeing in the new stores.

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

And Greg, I would just add, this is Curtis. Again, the same way that we've reshaped how we pick sites leveraging customer data and understanding the uniqueness across 72 Mosaic is an opportunity now as we look back into the core stores and identify the ones that aren't doing as well as others. And you use that same data to really understand the pockets of the customer that are struggling a little bit and where we need to do a little bit more. And so that's work that's ongoing as we continuously learn opening new stores and looking back at our fleet. I think that -- leveraging that data set the way we have to pick better sites will also be something that will help us to reinvigorate growth in the core.

Greg Malik - *Evercore Inc - Analyst*

Thanks and good luck.

Operator

Samuel Barton, Melius Research.

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Samuel Barton - *Melius Research - Analyst*

Good afternoon. Thanks for taking my question. I just wanted to follow up on the data in the retail media. Wondering if you guys had a view on agentic shopping and how it might relate to less human traffic through the site if more shopping is done through an agent and just the quality of data as a result? Thanks so much.

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

Yes, you bet. We've certainly taken a look at it both on what's happening around us and in our space. We haven't seen anything to indicate that agentic shopping is having a negative impact on us. And rather, we're looking at how do we lean on that as a way to continue to help customers find the unique needs. I think that's where you'll see people, in our space, use that shopping is to help continue to solve the need states and solutions that we're uniquely positioned to deliver. And we're certainly looking at some things in the commerce experience right now that can help us stand out and do so. We're not ready to speak about at this point. But I don't believe there's any negative consequence that we've seen so far from the world of agentic shopping.

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

And I'd just add as far as data goes, I mean that -- it's critical to have your data in the right place as we look ahead to leveraging AI across the business. And so that's -- as we talk about technology investments and modernizing what we're trying to do in the technology space, certainly, data is going to play a big role in making sure that we have that in the right place, and that will be a place of investment for us here going forward.

Operator

Scott Mushkin, R5 Capital.

Scott Mushkin - *R5 Capital LLC - Equity Analyst*

Hey, guys. Thanks for taking my question. I actually have two. I wanted to drill down on pricing just a little bit. It seems like when we look at our data that the pricing in produce, and I think, Nick, you alluded to this already, there's some challenges competitively in traditional or conventional produce. And I was just wondering as you think about margins going forward, I'm not sure that's going to go away. And so as you reset, do you think you've kind of accounted for that?

And then the second thing about pricing is just as we go through the rest of the store, the affordability with a lot of your stores in more middle-income areas how do we think about those items and the affordability there and what you can do? And then I have a follow-up.

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

Yes, thanks, Scott. Let me start with on the produce side. As I mentioned, it goes back to, I think, what we're seeing in the market. There is intensifying competition. That's one of the spaces in produce where we are seeing it. And then coupled with the affordability challenges in the market and the macro, I think the customer is making choices on what they buy there.

I look at producers again as a business of strength for us. We sell a lot of produce. It's core to who our customer is. It's core to our value proposition. We have a strong capability to source it and find good costs and deals to pass on to the customer.

I think the opportunity for us is how do we be more balanced and how we do that across conventional organic, as I mentioned, for us, and the right commodities at the right time to do that. And the teams are working that and putting that in place as we speak.

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On the affordability side, on kind of -- I think you were saying kind of mid markets. This goes back to, I think, what we're seeing from our customer is breadth of offering to help these customers who are health enthusiasts that may not have the highest income, giving them affordable entry points, as I mentioned. Like if you want to have a healthy specialty egg, we have an amazing Sprouts brand cage-free egg, we need to make sure it's affordable every day to get into.

I talked about the conventional produce space. And then as I've talked about these target customer items that are most -- that are drivers of choice for healthy options, that's the third area where whether you're higher middle or low income and you're looking for the healthy options for our unique customer, we just need to be right every day on that, and that's where -- one of the areas we're making an investment.

Scott Mushkin - *R5 Capital LLC - Equity Analyst*

That's great. And then my second question is around execution and the consistency of that execution, particularly in the produce area. So we've seen obviously some of these -- I mean, it's not obvious, but we see it, some of the mass merchants, particularly Walmart have really improved their execution in produce in particular. So how do you think you guys fit into that? We've seen in our store business some inconsistency there. So how do we -- how do you compete and make sure your execution is where it needs to be in the marketplace?

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

Yes, thanks, Scott. I think a couple of things. One, our customers tell us produce is still a really key reason why they choose us and why they love us. And I think there's always opportunities to improve execution, but our customer still tells us that they like our produce and they like the experience of it.

I think as we mentioned, when we're not moving the units as fast as we need to, that challenges that model [and so on], on freshness and on shrink and the customer experience, and that's part of why, I think, being better on pricing across the board in produce will increase unit velocities, will increase freshness. Volume will drive freshness, as you know. And I think that's going to help both sales, but also the customer experience.

And there's some work we continue to do in assortment to make it easier for our stores to execute. I think we ask a lot of them in the differentiation we have. We'll continue to differentiate. I think we can get tighter and simpler in how we execute produce in stores to continue to be the leader that we are in the produce space.

Scott Mushkin - *R5 Capital LLC - Equity Analyst*

Thanks, guys. Appreciate the color.

Operator

And this does conclude today's Q&A session. I would now like to turn the call back over to Nick Konat for closing remarks. Please go ahead.

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

I just want to thank everybody for joining us today, their interest in our business, and I look forward to connecting with many of you on our business in the future. Thank you.

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Operator

Thank you so much for participating in today's programming. You may now disconnect.

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