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EDITED TRANSCRIPT

SFM.OQ - Sprouts Farmers Market Inc at BMO Capital Markets Farm to Market Conference

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CORPORATE PARTICIPANTS

Denise A. Paulonis *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Jack L. Sinclair *Sprouts Farmers Market, Inc. - CEO & Director*

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Kelly Ann Bania *BMO Capital Markets Equity Research - Director & Equity Analyst*

PRESENTATION

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Great. Hopefully, everybody could hear that video from Sprouts that just played. I'm Kelly Bania, food retail analyst at BMO Capital. Really excited to have the opportunity to have this discussion with Sprouts Farmers Market. Happy to introduce CEO, Jack Sinclair; and CFO, Denise Paulonis. Hopefully, I've said that right, Denise.

All right, very much appreciate you taking the time to join us from Phoenix today. Obviously, I wish we could meet in person. Jack, I don't know if you know this, but we actually did meet in person many years ago in the back of a Walmart. So...

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Oh, of course. Yes. Okay. Yes.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

But obviously, a lot of questions. A lot going on with Sprouts and in the grocery industry in general. It's coming up on 2 years now that you've -- about 2 years almost that you've been at Sprouts. So I have tons of questions here. I just want to remind the audience, you're welcome to submit questions to me, and I'll try to loop them in here.

But just wanted to really start with just the big picture strategy, that's where most of the investor questions seem to set. And there -- my understanding is that your assessment of Sprouts coming in was too much promotion, overly promotional, unproductive promotions. Let's step back and stop catering to that customer and really focus on uniqueness, differentiation. And so I guess the question is, one, a lot of questions with this, but how do you describe your overall promotional intensity today? And what you've learned over the past 2 years about what has worked and what hasn't?

QUESTIONS AND ANSWERS

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. And I think it's a good question, Kelly, and it goes to the heart of what we've been doing over the last sort of 18 months or so. The thing that struck me early on was that our targeting wasn't targeted enough. We weren't clear enough about who we were speaking to. And in terms of our communication, our promotions, our merchandising even and even where we were put in stores, so the whole context of what we've been working on over the last 18 months has been anchoring our merchandising, marketing and real estate against our target customers. And we are fairly disciplined about segmenting the customer base, and we call them health enthusiasts and innovation seekers. And that chunk of business is a narrower chunk of business than I think probably everybody else is going after, which is making us a more special specialty retailer.

The focus on our businesses to be winning market share with that group of people. We're $6 billion of what we believe is a $200 billion market within the context of our geographies. So we don't need to grow a huge amount of share with a limited number of people, and that's the whole

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focus of how we've changed. And the promotion strategy is a function of that as opposed to the whole thing. The merchandising, how do we get differentiation in as many categories as we can? How do we relaunch categories? How do we position organic produce differently to everybody else? How do we position our keto and paleo and gluten-free and this attribute-based aspects of our frozen and grocery and dairy? We're changing our meat sourcing round.

So when -- the question on promotions is a very live one, and it's -- I'll come on to it, but it's much, much more than just what we're doing with our promotions. It's how do we shape the merchandise we put in front of our customers, how do we organize our stores? How do we get stores in the right place as part of the growth because we understand who the customer is, and that's the big focus of a lot of our work on customer analytics

(technical difficulty)

promotions is pretty similar. The whole context behind it has completely changed. And the deep cut nature of it, which does tend to attract coupon clippers who kind of run around from 1 store to the next, and that context has changed. And clearly, the pandemic made all this stuff a bit more even more confusing in terms of what was happening from a traffic point of view. But we -- we've been pretty single-minded about that. Let's focus on the target customer and do what's relevant for those target customers.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

So a couple of follow-ups there. So when you talk about a $200 billion opportunity, if we think about grocery is $800-something billion, that would kind of infer that 1/4 of that is really those health enthusiasts the natural and organic focused consumer. Is that really the way to think about it?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Well, our number is a little bit bigger than that. I don't know if Denise can help me with this one, but we are thinking it's more like a $1.2 trillion market that we're playing in, and we're $200 billion of that 100 -- $1.2 trillion. And that $200 billion is in the catchment areas around our distribution center. So it's a bit more than that if you took it around the whole country, but we're not in the whole country, so -- and we don't plan to be anytime soon and where we don't have distribution capabilities anytime soon, I think there's opportunities in the future there.

So it's $200 billion of $1.2 trillion, so it's about 1/6. And I'd probably say the 2 segments we are looking at are a little bit smaller than some of the other segments, coupon clippers and convenience is the other groups that we look at. They are kind of bigger in terms of absolute numbers than our coupon -- than our target customers.

Denise A. Paulonis - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

And the only thing I'd build on is you mentioned that they're all natural and organic shoppers. I think we think about it as a health enthusiast and an experienced seeker. And it's not that they only buy natural and organic, but they gravitate to what's new and different and healthy, which is the broad platform of what we sell in the store is not necessarily only organic shoppers.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Okay. No, that's a fair point. So I guess as we think about the merchandising today in the store, what percent of SKUs, and I don't know if this is something you track or think about, but what percent of SKUs are really differentiated from conventional supermarkets? And has that changed over the years?

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Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. We've certainly expanded our differentiation. And the thing that we're always looking at is, if it's being sold in a conventional supermarket or in a mass merchant, I would be disappointed that we're selling it at all. So we're kind of at the point where we've said 68% of our products are attribute-based. And some of these things appear in small volumes in other places. We look at ACV, the percentage of where these things are distributed. And if it's very, very low, it's in a few other places, but it wouldn't be in a lot of other, that's the kind of benchmark that we look at.

So in our -- in areas like grocery, dairy and -- frozen might even be up to 90% of our products are differentiated. Dairy is probably closer to 80% or something like that. A lot of our dry grocery areas will be kind of 65 to 70 differentiated products where you can't find them beyond in very small places, small volumes in other places.

Our organic produce mix is a big part of differentiation as well. We're running about 35% of our produce business is organic. That's pretty different to how a conventional would be looking at is mix of organic sales in that business and produce is a much bigger proportion of our business. Things that we're doing that I want us to get even more differentiated on. For Memorial Day, we're relaunching our meat category, where it will be 100% Angus and 100% in terms of differentiated grass-fed. So there will be grass-fed and Angus, that's the first time I think anyone has been 100% Angus and grass-fed. So that's going to -- where do we need to go to make it relevant for those target customers and make it differentiated.

And the other thing that we're doing in our merchandising is something called find a new favorite where we're really trying to be at the front end of all the innovations, a lot of interesting entrepreneurial innovators in the food industry that just won't get to Walmart and Kroger and Costco, not because they don't want them, it's just they're not big enough in sales or big enough in volume to justify their space. We want to become the destination.

I think in some categories would become so the destination for products that fit into that differentiated proposition. And we continue to expand on that and try to be the place where almost like if we could make sure every week, 20% of our products were brand new, not sure we'll get to that point, but that would be the kind of feeling you'd want in the store where people go and go, "Wow, I can't believe they've got this. What's this? What's that?" And our store format will be very much trying to put those things in front of the customers. And when we get back to sampling and testing and those kind of things, we think we can create quite a buzz in the stores around a lot of new things that are coming through.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

I guess on that point, what did the pandemic do to that cycle of innovation from those kind of small suppliers?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Funny enough, a lot of people have said to me that, that should have slowed down. I think what happened was the big CPG companies, Kelly, kind of had to consolidate their volumes into fewer SKUs. So you've got that kind of trend where people were trying to just be in stock of the big, high-volume SKUs.

Simultaneously, the smaller guys who are trying to get things going, I think, saw an opportunity, and we've been quite surprised by the level of interesting things that we're either finding or are finding us through the course of the pandemic. And I think it is a contrast with how the big food companies have been rightly been thinking about how do you keep your volume and your in-stock right. You probably have to call it a tail. And that tail has probably that meant less innovation coming from that group, which maybe has created a little gap for us to kind of fill that gap with interesting things that relate to the health space that's become -- the health space become very obviously important through the pandemic. And I think products that are around immunity, not just in our vitamins and supplements category, but across the board, immunity products, products that are -- got health benefits are something that people are showing a lot of interest in with us.

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Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Right. And I guess just before we kind of move on here, just in terms of the -- there's a lot of merchandising effort -- initiatives that you talked about there. Can you just help us understand the merchandising organization? What it looks like now versus when you came in? Obviously, there's changes at the DC level. But beyond that, just in terms of really merchandising those stores and focusing on those unique products. Like what is the team that is focusing on?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

We restructured a little bit and put 2 effectively 2 CMOs in place. One CMO who's running the whole of fresh, all of our fresh initiatives and 1 CMO who's running all of our nonperishable initiatives. So 2 groups will split that in 2 because there's 2 very different things going on in that and as we work that through. So we've gone from 1 CMO to 2 CMOs. We brought a new Chief Marketing Officer in place and restructured the marketing team supporting that merchandising team.

We have a supply chain lead and a lot of the work with the fresh merchandising, in particular, is about restructuring our fresh sourcing organization to make it more local, more seasonal, more relevant to the -- what a farmers market should be in terms of being able to kind of take advantage of the specific things that are going on behind the scenes. Or I mean that's a big part of the Colorado DC that we've just opened. How do you create an opportunity for the buying team based in that DC to create the excitement around the seasonal -- Colorado has got this little window where it's really, really seasonal, and you got to be right on top of it. And I think it's something, as I've kind of observed the U.S. grocery scene, nobody that's national does this very well because it's really hard to do it, except in Phoenix, trying to figure out what's happening with Jersey tomatoes. You need somebody close by to it to figure it out.

And the only retailers that are any good at this are the ones that are only in the regions that they're in. Something like [HEB] do it well because they're only in Texas. They do not have to think about Jersey or California. So we're trying to create this hybrid merchandising model that will allow us to take advantage of being a local player, but some of the benefits of scale that come being across the country, put the 2 things together. So we've restructured our fresh produce organization behind that very specifically. And further down the line, we've got some really good people. I've been really kind of impressed by the strength of knowledge around attribute-based products that fundamentally exists in the DNA of Sprouts, and we're trying to kind of blossom that and bring that forward a little bit more as well with some of the people and some of the promotions we've done down in the organization.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

I guess on that point, what are you seeing -- or used to think of kind of your big competitors as really Whole Foods and Trader Joe's? What are you seeing from them over the last year? And as things start to get more normalized here?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Well, notwithstanding the traffic, they both have the same kind of traffic trends as us because they're not a destination kind of you can't get all your shopping there. So it's probably -- they've probably seen some of the same traffic dynamics around the pandemic. But notwithstanding that, I actually think Trader Joe's are a very complementary retailer to some of our best stores are the ones that are right next door to Trader Joe's. Because I think they do a nice job on certain things, and they do a nice job on like frozen and wine and what they do on snacks and chips and stuff like that. They do quite a nice job on that, not particularly health focused, but really interesting stuff.

So I think customers actually quite like the idea of going into Trader Joe's and then get into Sprouts because I think we've got a point of difference and advantage on our fresh produce business and a lot of our aspects of our fresh business and some aspects of our vitamins and supplements business. So I think there's a complementary there.

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So as what have I seen from them, they've had to turn back Trader Joe's a little bit of the excitement around sampling because of the pandemic, which I think takes a little bit of heat out of what makes them interesting and makes them good.

Once you move on to Whole Foods, I think they've become, well, clearly, the Amazon acquisition has made a huge difference to how they think about Amazon Prime and how that creates the assortment. I've been surprised by the number of what I would term conventional products that are appearing in Whole Foods, which maybe is creating a little bit of an opportunity for us to be what they were 10 years ago or which was the destination place for people with interesting new things that are very kind of attribute based. So we see a little bit of a gap in that. As they've looked at the data, I suspect this encouraged them to bring a lot of conventional products in. And that, I think, leaves a little gap for us going forward.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

It's an interesting point. So if you think about that consumer, I guess, Whole Foods is taking an approach that maybe their consumer is a little bit of a crossover consumer, buying some conventional. What do you think your core enthusiast or health enthusiast customers, do you think they are really doing that as well and buying still that kind of crossover mentality? And is that okay? Do you say that's okay, you can go to the conventionals for that, but for Sprouts, here's what you can expect.

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, exactly because we don't expect to be a destination for all your shop. Families are quite complicated and people buy this for this member of the family and that for that member of the family. We can become -- we've got a lot of passion in our customer base, but they still go shopping somewhere else because there's other things that they need to buy. And that's part of our kind of thinking that we can grow our business comfortably but by getting just a little bit share of the wallet of the health enthusiasts, not the full shop of the health enthusiast. And that's where we're putting the right things in front of people and making some inspiration around the products that we're selling and how we sell it should allow us to get a little bit more share, but it doesn't need us to win a trip from either Whole Foods or Kroger or -- because that's not what we think will be the way that we get to our growth numbers.

We want to give access to this proposition, have a unique proposition that you can't get anywhere else, but we're assuming they're going to buy some food somewhere else as part of this exercise. And that's maybe where Whole Foods are coming that they're trying to do it all in the 1 shop. But ultimately, you'll end up not differentiated. You'll end up with a lot of conventional products in your store. And that's what we've got to avoid because we're not going to win by carrying conventional products at higher prices than the conventional grocers.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

So I guess as I think -- we think about the last year or 2, so there's been all this trip consolidation. Kroger was just talking about it. Convenience, you can get everything in 1 stop. And obviously, the last year is not a normal environment. But as you think about that consumer, is there any worry that those competitors that maybe took some of that share over the last year are doing and can do some things to keep them engaged with some of their differentiated products, and they all talk about personalization and so forth. And so I guess just what is that catalyst? Because what does it say about their commitment to that consumer's commitment to those differentiated things if they spent a year plus at a conventional supermarket?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. And I think -- as I think about our business and what's happened, I don't think we've lost the people that we're talking about. I think we've lost the people that we're not talking about, which is the people over here. Now the pandemic clearly has confused that for us, it mean a much cleaner picture. But think about our growth in e-commerce, I think that's because our customers, our target customers were worried about going out the home because of the health consequences of that, but they had to get access to Sprouts. Not all the shop, but access to -- so our e-commerce business grew into the teens from low single digits as a percent of sale. So I think that was a function of those customers accessing products that

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they couldn't access anywhere else. It was the only way they could get to the Sprout's products that they can't get anywhere else. So I think that dynamic was in play.

And then -- so that kind of -- the people that we lost in terms of the physical traffic to the stores, I think were the ones that we would have lost anyway because of the promotional thing that you started off talking about, Kelly, that deep-cut promotions that was driving certain people into the store, they were going there to buy that if our price was cheaper on chicken than Kroger.

Now that clearly is the kind of customer that we probably would lose anyway. And on top of that, you've got -- I don't want to shop as many places, which Kroger have talked about, we've all talked about. It used to be 4 or 5 places, down to 1 or 2. That will bounce back. And I think that will benefit us. But it might not benefit us much because of the promotion stuff because we're not going to rush back into doing deep cut promotions.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Right. Right. So many questions here, time is flying by. So as we think about digital, 1 question I've been wanting to ask is just about -- a lot of retailers are talking about alternative profits as a component of their digital profitability, their path to profitability. Kroger was talking about it this morning. Walmart was talking about it yesterday. Where do you stand on this? And is that -- could that be an important part of your ecosystem down the road?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

It's not part of the immediate. We're a premature business relative to Kroger and Walmart and how they think about those kind of things. We've had -- we've not really had a marketing department, Kelly. We've had a department that produced a lot of paper flyers. And the evolution of that, we're very pleased by some partners that we're working with in terms of how this might evolve and develop going forward. And there's clearly revenue streams in this, as I've looked at in other companies.

At the moment, our bandwidth isn't that we're going to chase after that, and it's not part of our 3-, 5-year planning, but these things are changing fast. And certainly, our customers and communicating with them and working with the brands, there's some mileage in this.

Our brands tend to be much smaller than the brands that are funding a lot of this kind of work in-grocery, not outside of grocery but in-grocery. A lot of the brands that are funding are shifting big marketing dollars from one thing to the other to get into that space. Our business is more likely to be working with much smaller brands. So it's unlikely to be the same scale.

Having said that, there's mileage in how we can communicate more directly with our customers and work with our partners to do that. And certainly, the media mix that we're working with and the media partners that we've got, we're exploring some aspects of that in terms of going forward. But I wouldn't see it as today being some

(technical difficulty)

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

What -- where can digital be in terms of the margin? It sounds like it's positive for you. But where do we think about that going longer term? You've already gone to low double-digit penetration in a short amount of time as that continues to go up...

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

I'm going to let Denise get into the numbers a little bit on this, which I think is quite an interesting one. But you're right, the customer has not migrated to that. I think in a fresh food environment, it will kind of drift back down further than it will in a -- less -- people will buy grocery and

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continue to buy grocery on their coffee and their big cereals and their water and their diapers and those kind of things will continue to be a big part of it. I'm not sure that will go back anywhere near where it was. But I think fresh foods, people will drift back into wanting to go and experience the smells and the colors and what happens in a fresh produce environment. It's certainly a part of our proposition.

But in terms of the numbers for digital, the sales bit in terms of e-com, I'll let Denise talk about. In terms of the digital communication, we're working pretty hard at that and made a lot of progress on how to communicate directly with our specific customers. Denise?

Denise A. Paulonis - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes. And I would just build on that. I think to put some numbers around our digital sales, so our e-commerce sales that we have today, prepandemic, we started out below 4% as penetration into the business with really the belief that people didn't want to come in and experience what was new and different in our stores, the nature of shop they were. We came out of Q1 at about 12% penetration of e-commerce into the business. And with us, I think to Jack's point, a lot of this is about -- we have a lot of customers who probably have a little bit more risk aversion than the average customer just based on their health and wellness trends and things like that. And between our own shop.sprouts.com and our partnership with Instacart, we kept the capacity very high. So if people want a quick turnaround for curbside or home delivery, they really are able to get that fast turnaround, kept up the [velocity] very nicely.

And for us, we do have a profitable e-commerce business. And people ask the question, well, how can you have a profitable e-commerce business? And it's not rocket science for us because there's a few things that are different from us than a conventional grocer. I think, thing number one, given that much of what we sell is attribute-based, in all honesty, those products start with a higher margin than what a core grocer would be selling in terms poor CPG. So we start with a little bit more room than other folks do.

We do our curbside pickup. We do that work internally to fulfill that order. So we're able to leverage people who understand where our product is in the store, can do that on an efficient basis, and we can schedule labor and be flexible with labor scheduling to make that part a bit more profitable. And then the third part is, not surprisingly, an e-commerce basket is generally a little less promotional of a basket. So if we have about 1/3 of the store on sale at any given time, which is probably typical for us, as Jack mentioned, you're going to see less of those items necessarily in that e-commerce basket. So once again, it starts as a little higher margin.

The 3 of those combined more than offset what we end up with fees coming through to fulfill those orders. So once again, it's just back to being that specialty grocer in what we're selling than necessarily a conventional grocer with where the margin structure starts.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

That's really helpful. I guess just on digital, a couple more questions. What is your pricing policy with Instacart? And has it changed? Or do you see it evolving over time?

Denise A. Paulonis - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes. We've actually -- since the beginning, and it's still what we're doing today, we have the same prices online and in-store. And we think that that's the right positioning as the world is evolving today, and we want to remain competitive. We look at other options, we'll continue to look at options. If there's anything we would do to better connect back to customers, identifying themselves and us being able to capture some of that data would that provide a different pricing profile. So we'll explore things like that. But right now, for the customer, we think the right thing to do is to keep them the same.

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Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Okay. Maybe just switching gears a little bit. So -- and just as a reminder, feel free to submit questions to me. I don't see any here, so I'll keep going. Vitamins and supplements. So I always thought about that as a very important category for Sprouts that wasn't maybe talked about enough. We tend to focus on the produce, but it's a big margin driver for Sprouts. And so I guess 2 questions. One, how do you think about online competition there? Because that does seem like a category for the Amazons and the Costcos and the Walmarts to ship and is lightweight and there's that consideration. And just what are the trends that you're seeing in that? I mean, obviously, pandemic [were to lock] that. But what do you see over the next couple of years in terms of trends in vitamins and supplements?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. It's something that I find so exciting when I go into the stores. It's my favorite part of the store. To be quite honest, I've learned an awful lot in the last couple of years just talking to the managers. The people we have running those departments are truly inspirational and truly understand the context of natural supplements and vitamins in helping people navigate through whether it's problems that they've got or things that they're thinking about. They're almost like many pharmacists in terms of how they make it work. And retaining that skill base and that training part of it is truly different, is truly a part of our differentiation. And when you see our customers interfacing with the people who are running those departments and the support teams there, you really do get -- it's almost like a consultation.

So the challenge for us is -- and that's the key to our differentiation. What you find when you're competing online with Amazon and Walmart [on price], you're competing online in a limited number of SKUs and a lot of kind of high-sized pack sizes. And those are things where we're not going to win on price. We'll try and make sure we're at the right place, not in stupid place, but we're not going to win on price on those. But what we can win on is people having absolute confidence that they get the right advice in terms of how it makes it work. Interesting things like we sell chilled probiotic products in that space. You can't get chilled probiotics from Amazon. You can't. And that's a big part of an evolving trend of wellness.

And how does wellness -- the way I describe it is wellness inside and out, how do we create this feeling of having products that contribute to wellness. And our people understand that we've got a really strong team on this, and the evolution of product in this space is moving quite fast as well. We think there's some really interesting things happening that we can stay at the leading edge of. What's going to happen going forward? I don't think anyone's ever going to get the flu again if the way the world carries on the way things are going at the moment. So that made a big change.

Our January business was usually not busy on flu type things, homeopathic kind of natural remedy flu things. That clearly has gone away as an issue in the country. Will it come back? I don't know. But what I do know it's going to be strong for us as immunity is going to stay being a really big issue going forward.

The whole wellness context of this, how to take things to make you prevent getting diseases as opposed to solving problems that you have afterwards. And the team are working really hard in that space. So the key to us is having differentiated products, bringing brands in ahead of everybody else and retaining the strength of our training and our people, so that we're actually truly differentiated in the marketplace. And I think we're there at the moment. We just have to be clever about how we get our product in front of people at the right time and communicate it effectively.

And it is an area where promotions can be quite powerful, where we've got this thing, if you spend $100, you get a bigger discount. So things -- there's things we can do there to drive some loyalty into it that we continue to work on. But it's a great department, and it is really part of the [crux] of this unique mix that we have between produce at great value and the rest of the store attribute-based, margin driven. Vitamins was a key part of that when this thing all started up. And part of my whole thing here is how do we get this back to how it started in San Diego all those years ago with little stores with great fresh produce, but everything around it being targeted around the health and wellness agenda.

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Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Right. Right. So time is slowing back here. I wanted to -- I had 2 more questions. I wanted to make sure to fit in. One was just on wages and labor, big topic everywhere. But for a retailer that has so much growth, new store growth ahead of them, you'll need to hire a lot of people. So just curious, how you feel about your wages? I think your -- I think we saw that your average is just over 17. Where is the starting wage? Do you think you need to step that up as you kind of have this -- these growth plans over the next couple of years?

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Well, we certainly have to make sure we've got people in the stores to look after the customers when they're coming in. And with these number of stores, it is something that's very alive. The live issue at the moment is -- are enough people. We don't lose as many people as others because there is a little bit of a kind of -- if you work for Sprouts, you kind of see it more as a kind of -- there's a little bit more purpose to it. People kind of -- it's quite inspiring, meeting a lot of the people in the stores. We pay a little bit more because it's a bit more specialist. If you're a vitamin specialist and a meat specialist, the sort of specialist people we have in the store. So our average mix is a little bit higher than what you would find in a conventional grocer. And it clearly varies by region, very different in Texas to what it is in California, just by nature of different jurisdictions and minimum wages and those kind of things.

I think we're well placed to manage that as it goes through. There are some short-term pressures in the middle of this, Kelly. This issue today about how do we get -- how do -- there's lots of jobs available, but how do we get them filled fast enough? And part of that's around, and I don't -- it's not a political comment, but I think the unemployment benefits and what's it doing to [whether] people have taken their jobs or not. I think that will unravel itself over the next 2 or 3 months, and we'll get in a place where it's a bit more normal. But we've got to make sure we're more than competitive to get the kind of people that we want looking after the customers in a specialty retail environment. And it's a constant topic, and I'm feeling pretty good. I don't know, do you want to add something to that, Denise?

Denise A. Paulonis - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes. The only thing I would add is I think we also have a couple of employment practices that are really helpful to us in retaining employees. So we actually do a twice-a-year kind of merit and performance review. So folks don't have to wait 12 months to see an increase in their pay once they join us. They have that opportunity every 6 months to earn those changes, which we think is a good retention item. And it's also really good to develop people and understand where they want to have in their careers.

So I think to Jack's point, we've seen that help with retention. But overall, I think the positioning that we take on that starting wage, it is really tied to what somebody brings in terms of their prior experience and the position. So we have very few people who actually started a traditional minimum wage. That 17.5 number that you quoted, our starting wage is only $3-or-so below that, right, so in average. So that's actually a pretty healthy place to be.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Okay. That's helpful. Since we have just the lunch break afterwards, I'm going to take the extra minute or 2 to squeeze in 1 more question. But just in terms of the message, I guess, if you were to leave a message for investors here just on this topic of this concern about maybe where price gaps have gone? What would be your message to investors about where your price gaps are? Walmart was talking yesterday about a widening price gap to the market, which is there's a lot of competitors out there, right? But just where do you think your price gaps are? How focused are you on tracking those? Maintaining those? It sounds like there's a wide dispersion of how they're being managed over the last year. So just help us understand that.

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Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

I promise you, when Walmart were talking about their price gaps, they weren't talking about us because they fundamentally don't sell what we sell. That's the kind of fundamentals. But if you take to produce, our produce is an important part of the proposition. It always has been, always will be, and we have got good price gaps, particularly in organic produce with everyone, including Walmart. So right across the board, we're in really good shape. And we do have -- it's relatively easy to have a comparison.

Outside of produce, it's very difficult for us to have a price gap comparison. When you're selling 90% of your frozen foods is different to what you can find anywhere else. So the focus we're having on our pricing is elasticity, how does our price point work in terms of driving the sales? And that's the investment we're putting in, in terms of people and systems. It's not that helpful for me to look at Kroger's frozen prices. If I ever, [then their] selling is different to what I'm selling. So what we try and do is figure out what is the price point that sells well. And if it's too high, we'll bring it down. And if it's too low, we'd put up kind of thing. It's kind of it's elasticity that's driving it in the differentiation, but produce is a fundamental part of that. And we're going to look at meat. And your comment on vitamins is a good one. Those 2 categories have got more comparisons. That's why we're differentiating meat going forward.

The more we can differentiate, the more we can drive our business on value, not on price gaps. If you're sitting in Walmart, you haven't been there, but you have to look at price gaps. You've got to get the gap as wide as you can, invest margin, get the gap, drive traffic, drive full basket. It's a totally different world we are operating in. And I think the message to investors for me is think about us as a specialty food business, not a grocer. And if you do that, you'll be less worried about what's your price gap with Walmart or Kroger or anyone else because I can't -- I just don't think it's relevant to us. What's relevant to us is are we giving value to our target customers. And that's what we're trying to focus in on.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Perfect. I think that's a great way -- great spot to end. But thank you so much for taking the time. This has been very helpful.

Jack L. Sinclair - *Sprouts Farmers Market, Inc. - CEO & Director*

Thanks, Kelly. I appreciate you.

Denise A. Paulonis - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Thank you, Kelly.

Kelly Ann Bania - *BMO Capital Markets Equity Research - Director & Equity Analyst*

Okay. Have a good day.

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