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EDITED TRANSCRIPT

SFM.OQ - Q1 2022 Sprouts Farmers Market Inc Earnings Call

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PRESENTATION

Operator

Hello. Thank you for standing by, and welcome to Sprouts First Quarter 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Susannah Livingston, Vice President, Investor Relations and Treasury. Please go ahead.

Susannah Livingston - *Sprouts Farmers Market, Inc. - VP of IR & Treasury*

Thank you, and good afternoon, everyone. We are pleased you have taken the time to join Sprouts on our first quarter 2022 earnings call. Jack Sinclair, Chief Executive Officer; and Chip Molloy, Chief Financial Officer, are with me today.

The earnings release announcing our first quarter 2022 results, the webcast of this call and quarterly 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 2022 and beyond. These statements involve a number of risks and uncertainties that could cause actual 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 along with the commentary on forward-looking statements at the end of our earnings release issued today. Our remarks today include references to non-GAAP measures. For a reconciliation of our non-GAAP measures to the comparable GAAP figures, please see the tables in our earnings release.

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With that, let me hand it over to Jack.

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

Thank you, Susannah, and good afternoon, everyone. We are pleased with solid first quarter results and believe it is a sign that many of the strategic changes we've made over the past couple of years are beginning to materialize. The turn to positive comp sales supported by positive comp transactions, while at the same time, maintaining stable gross margins was extremely encouraging. During the quarter, we successfully attracted new health enthusiasts and innovation seeking customers by continuing to focus on providing both the freshest produce at great prices along with a wide variety of differentiated attribute-based products. This was especially important during the all-important New Year's resolution season.

Our earnings for the quarter benefited as our pricing caught up with inflationary trends, leading to better-than-expected gross margins. We also made good strides in our unit growth objective with the addition of 6 new stores that spanned across Colorado, Texas and Florida. One of the stores that opened during the quarter and the majority of the remaining stores opening this year will be in our new format. All of this was possible due to the resilient Sprouts team. Many thanks to them as they remain diligent in keeping our fresh supply chain running and our shelves stocked while at the same time caring for our customers by providing friendly service and product knowledge.

While we are pleased with our strategic changes and the positive impact they've had on the business, the near-term landscape has changed a bit since our last conversation with you, which is slightly impacting our outlook for the remainder of the year. Chip will provide details relating to our financial performance and our current outlook. And then I will follow up with more details relating to our focus for the remainder of 2022 and how we're navigating the current environment.

With that, I would like to turn it over to Chip.

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Thanks, Jack, and good afternoon, everyone. For the first quarter, total sales were $1.64 billion, up $66 million from the same period in 2021 driven by comparable store sales of 1.6%, supported by positive comp transactions and new stores.

We did benefit early in the quarter from the King Soopers strike in Colorado and the height of the Omicron variant. That said, we experienced both positive comp transactions and positive comp sales each month during the quarter. We are encouraged by our top line growth while simultaneously maintaining our gross margins.

E-commerce sales were 11.5% of total sales, which was also slightly elevated during the early part of the quarter due to the Omicron surge. We continue to experience strength in our deli business as consumers search for both healthy and easy meal options. We also experienced strength in those areas with our greatest breadth of differentiated product such as grocery, dairy and vitamins.

We are particularly proud of our merchandising, supply chain and operations teams as they managed to keep our shelves stocked with both perishable and nonperishables in a challenging sourcing environment. We continue to see our customer engagement grow from a digital standpoint with increases in account sign ups, active e-mail users and text subscriptions. We also saw positive trends in customer retention rates, while our customer satisfaction scores remain very high.

Our first quarter gross margin was 37.3%, essentially flat when compared to the first quarter of last year and better than we originally expected. We passed through inflationary cost and are closely monitoring price elasticity. We continue to test promotional strategies to drive positive traffic without sacrificing overall gross margin. That said, we are continuing to experience slightly fewer units in the basket when compared to the same period last year.

SG&A for the quarter totaled $460 million or $20 million higher when compared to the same period last year. Increases were predominantly driven by new stores and higher in-store labor and supply costs. We also spent approximately $2 million relating to California's 2022 Supplemental Sick

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Leave Law that provides paid time off for COVID issues. We now expect the total cost to be approximately $3 million by the time the law expires in September 2022, unless there is another variant outbreak.

Total SG&A increases were partially offset by timing of a portion of our marketing spend that will shift to the remaining 3 quarters of the year. For the quarter, our earnings before interest and taxes were $120 million, interest expense was $3 million, and our effective tax rate was 24%. First quarter diluted earnings per share was $0.79, an increase of 13% over the same period last year. During the quarter, we opened 6 new stores, spent $22 million in capital expenditures net of landlord reimbursements and repurchased 1.5 million shares for an investment of $46 million. Our strong cash flow from operations of $153 million continues to fully support our ongoing capital needs.

Turning to the balance sheet highlights. We ended the quarter with $324 million in cash and cash equivalents, $250 million outstanding on our revolver, $25 million of outstanding letters of credit and a net-debt-to-EBITDA ratio less than zero. As you probably saw on March 25, we closed a $700 million revolving credit facility, which replaced our previously existing $700 million revolver. The terms and conditions are substantially similar to our previous agreement with a new expiration date of March 2027, as well as the addition of ESG-linked pricing terms.

While we plan to continue to fund operations and unit growth through our robust cash flow generation, this facility provides Sprouts with greater financial flexibility as we grow. As for our outlook, our view today is slightly different than it was at the beginning of the year. We believed we could drive slightly positive comp transactions, our proxy for traffic, throughout the year. More importantly, we believed year-over-year inflation would begin to dissipate as the year progressed and the declines in units per basket would slowly stabilize.

However, inflation is not slowing and customers continue to put 1 to 2 fewer items in their basket this year than last. We can speculate a variety of reasons as to why the fewer units - rising gas and utility prices, a flight of precious discretionary dollars to more experiential offerings such as travel or restaurants, et cetera. The good news is that our comp traffic is continuing to be positive and in many ways, driving more units in the basket is a bit more within our control. Jack will not only address progress towards many of our multiyear initiatives, including those that attract more customers, but also near-term tactics to stimulate demand while in the store.

With all that said, we now believe it is prudent to expect total sales growth, comparable store sales growth and earnings per share to be at the low end of the outlook we provided during our last earnings call in February. As a reminder, that outlook included 4% to 6% total sales growth, 0% to 2% comparable store sales growth, and $2.14 to $2.24 earnings per share. We are still on track to open 15 to 20 new stores and invest $150 million to $170 million in capital expenditures net of landlord reimbursements. For the second quarter, comparable sales should be close to flat and earnings per share is expected to be between $0.49 and $0.53.

With that, I'll turn it over to Jack.

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

Thanks, Chip. Despite the current environment, the company remains laser-focused on delivering the long-term vision for Sprouts and an immediate focus on building a stronger basket. Our relentless focus on product differentiation in partnership with our vendors is what sets us apart as a specialty grocer. We believe this is one of the primary reasons our target customers love to shop at Sprouts.

Considering this is so important to Sprouts, we just recently promoted Kim Coffin to Chief Forager to oversee innovation nationally across all departments. Kim and our team will build on the very strong foundations that we have with regard to product innovation in the health and attribute space.

Our merchandising teams are constantly in pursuit of new products based on healthy trends, taste and uniqueness. We conduct product tastings constantly. And while category reviews happen a few times a year, new cut-ins occur regularly to keep our shelves full of interesting new products. Our organization and small farmers market store are built to be flexible allowing us to insert new products in every store in a week, which our vendors love. It is this passion and our healthy product focus that drives new innovators and vendors to Sprouts, allowing us many exclusives and first to markets. In the first quarter alone, we released over 1,000 new items in the store.

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We've recently restructured our produce department and reorganized to improve freshness, seasonality, locally sourced products and unique and exclusive varietals. A clear differentiation for Sprouts is our dedicated local produce team, not seen at other grocers. With our local produce sales growing steadily, these teams are developing ever stronger relationships with smaller local farmers. We're giving longer term commitments to these growers, which provides fresher products and cost benefits that we are proud to pass on to our customers in better pricing, all of this reflecting our farmers markets heritage.

Building an advantaged supply chain closer to our stores was an integral part of our strategy to improve produce freshness and ties in nicely to support local farmers. With 2 new distribution centers behind us in 2021,this year, we're focused on optimizing these new centers in Colorado and Florida, especially with more local produce and systems at all DCs. We also plan to move our Southern California distribution center into a larger facility in 2023 to support our ongoing growth in that region. We've already begun to work on this facility, which will include ripening rooms to present fresher product to our customers and will be solar-enabled, LEED certified, and planned to support electric charging for commercial trucks.

Switching gears to our new stores, the pipeline remains strong, and with 6 new stores under our belt in the first quarter and a few more already opened this quarter. Based on our progress to date, we're confident we will be able to open 15 to 20 stores this year. Supply chains remained tight, but we're getting the necessary equipment for our builds this year.

Moving on, our journey in marketing continues. Data tells us that awareness is still an opportunity, and as it increases, so do our customer counts. As well, data also reinforces that produce value and product attributes drive customers to our stores. So you will see us hyper focused by reinforcing these 2 areas in our messaging, our merchandising and through our media investments.

I'm excited to have Nick Konat, our new President and Chief Operating Officer, on board to lead this endeavor. His experience in both merchandising and digital marketing are invaluable. Recent consumer data shows us that our current Sprouts customers give us credit for providing great value on produce. Our opportunity is the non-Sprouts shopper who may not be aware of Sprouts low prices on produce and actually perceive us as being more expensive in this category. By overtly telling non-Sprouts shoppers what our customers already know, we have great prices on the freshest produce, we expect to drive incremental traffic.

Sprouts is unique as we intersect fresh, value, and discovery like no other grocers. We have always held strong equities in fresh, and we are well positioned to grow perceptions in produce value and discovery of healthy new products across the store. These messages are being integrated across our marketing efforts to reach customers in our various trade areas.

Fresh and value are reinforced through owned and paid media channels, and we're stepping up the healthy discovery by focusing on influencers, customer experience, vendor partnerships and new product spotlights. Just this past month, we exclusively launched Mananalu pure drinking water founded by Jason Momoa, who filmed a promotional video in one of our stores for his sustainable movement campaign.

This one video post received over 13x the views we typically see, and it was the most engaged post in the past 12 months. We also partnered with Broadway Star and TikTok's sensation, Kevin Chamberlin, who sang a catchy jingle on social media, promoting the unique products shoppers can discover in store. Overarching the entire campaign will be our ongoing messaging, highlighted by differentiation, seasonal focus and, of course, value in produce.

I've been particularly pleased with our rollout of our new values - we care, love being different, and owning it. I'm sure this will have a significant impact to drive customer engagement and sales in our stores. As well, our community support continues to grow. Since its inception in 2015, the Sprouts Healthy Communities Foundation has granted $15 million to more than 300 nonprofit partners, which have brought hands-on, garden-based learning to 1.5 million children.

In April to strengthen and expand school garden-based education, the foundation hosted an inaugural Growing Schools Garden Summit in Denver, Colorado. As the first ever national gathering focused entirely on school gardens, the Summit united over 400 educators and leaders from across the country working to sustain school garden programs. These educators and the nonprofit organizations they represent, operate learning gardens at over 6,000 school campuses throughout the United States, providing hands-on nutrition science and academic instruction to an estimated 2.5 million students every year.

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Our community involvement doesn't stop at the foundation. Sprouts is committed to focusing on women's athletics by partnering with the Los Angeles Angel City Football Club as the team's founding back-of-jersey sponsor, making our first commitment to women's professional soccer and enhancing our support of the broader Los Angeles community. We were thrilled to support Angel City's inaugural soccer match last month. As well, we look to expand our women's sports platforms in the coming months.

One of the ESG topics we're always proud of is our food waste recovery, which increased to 78% in 2021, mainly driven by the donation on an equivalent 26 million meals to over 400 food rescue organizations across the country. These and many other stats can be seen in our 2021 ESG report that we just published this week.

So as you can see, we're feeling good about the progress we're making against the strategic objectives we outlined over 2 years ago. As we highlighted earlier, our traffic to our stores is positive, while customers are putting 1 to 2 fewer items in the basket. It is important for us to control what we can control and focus efforts not only on incremental traffic, but also building baskets, especially as the consumers' wallets get squeezed.

A few of our focus areas include in-stocks, bringing back a selling culture to our stores, key merchandising solutions, and basket-level promotions. Starting with in stocks, Sprouts has historically been somewhat challenged in this area due to unsophisticated systems and processes that make it extremely difficult for our stores and our merchants, resulting in less than optimum in-stock positions.

To improve this, last year, we embarked on implementing a new system that supports Perpetual Inventory and Computer-Assisted Ordering or PICAO. This system and associated processes provide greater visibility and accountability to inventory levels and shift store responsibilities from estimating and ordering to just counting. We're extremely confident this will improve our in stocks across the chain. We recently started the implementation by department and will soon have dairy and frozen completed across the chain. All departments will be completed by early next year. And at the same time, we're building out a true replenishment team.

Turning to selling culture. We want to bring more buzz to our stores. The pandemic restricted the opportunities to drive excitement in our stores. Our team members have to spend an inordinate amount of time on sanitizing versus being able to engage with our customers. We're bringing back assertive sampling in a big way, allowing our customers to taste and experience new products. Beginning in Q2, for the first time in Sprouts history, we have true labor standards in our stores and a system to support it. This will provide efficiencies by weeding out unnecessary and duplicative tasks and allows us to shift those hours towards more customer engagement across the store similar to our vitamin department today.

In addition to our store bonus programs, we're providing our stores more visibility to actual units in the basket and implementing contests within the regions relative to their associated performance. As it relates to merchandising, the front end of our stores are becoming more basket building with key seasonal impulse items. We're also rolling out innovation centers and more prepared meal fixtures in many of our stores. The innovation centers help create the ongoing treasure hunt and highlight new products in our stores. Our customers are telling us that they like the convenience of prepared, so we're stepping up our exposure to heat and eat deli meals and prepared one-pan meals, as time becomes a more precious commodity for our consumers.

Finally, as it relates to basket promotions, we're having some success shifting towards house or department discounts as opposed to specific items. We find these programs not only drive incremental traffic, but also deliver baskets that are 2x the average. I hope our comments today are helping you understand what we are building in Sprouts, a specialty grocer focused on wellness with differentiated product and the freshest produce at great prices. At the same time, I hope you believe we're working diligently controlling what we can control as we navigate the current economic environment.

At this time, we're happy to take your questions. Operator?

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Mark Carden with UBS.

Mark David Carden - *UBS Investment Bank, Research Division - Associate Director and Associate Analyst*

So I wanted to start by digging into the comp a bit more. We've seen some pretty strong top line results at grocers like public in recent days with inflation, presumably, I think it's a bit of a tailwind there. What do you think is driving the pressure in the other direction for Sprouts in your view, really, when you're thinking about your forward guidance? Are competitors investing more in price, is trip consolidation at larger grocers, maybe capping your transaction growth from being even higher than it is today. You also mentioned, of course, the fewer items per basket, or is there something else that's really kind of driving differential there?

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

Yes. Thanks, Mark. First of all, we're pretty encouraged by the transaction growth. So the fact that transactions are going up to something that's encouraging as over the last couple of quarters, and we think that is likely to continue.

The issue is, as you say, is units per basket. What we're not seeing is any real intense promotional activity from other people that's influencing that. And we think it's some of the macroeconomic environment that's existing out there. Inflation is clearly affecting people's ability to spend as much or to buy as many items as they come into our stores.

We think consumers are spending a little bit more on travel. If you look at the TSA data, it's pretty clear the number of people -- the increase in travel that's going on. So disposable income on that, I think, is probably going -- is restricting our basket a little bit. But as I said in the remarks, we do believe there's a lot in our control that we can drive it through. We're excited about some of the new merchandising and activities we're putting into store. We're excited about using some of the techniques to get our in-stocks even better than it's been over the last little while.

So we're focusing on the things that can grow our basket. I'm not seeing any intense promotion pricing activity elsewhere. I think this is in our own control. And we're focusing on controlling what we can control to drive that basket forward.

Mark David Carden - *UBS Investment Bank, Research Division - Associate Director and Associate Analyst*

Okay. Great. That's helpful. And then just as a related follow-up to that, it sounds like competitors are largely acting rational across the board with respect to passing through price even in these last couple of months where inflation has really picked up.

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

Yes, I'm certainly seeing rational -- margins are not -- there's nobody is investing huge amount of margin to try and drive business. I'm not -- I'm certainly not seeing that, that's under pressure in terms of we're passing on pricing, there's timing issues on that. But we're passing on pricing against the cost increases that continue -- as you're all very well aware of as it continues to keep pushing on the inflation rate. We're passing that one in pricing as is everybody else.

Operator

Our question comes from Scott Mushkin from R5 Capital.

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Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

I had a couple of questions, but 1 clarification first. I think it was said that marketing spend timing was -- some of it wasn't done in the first quarter, and it's going into the second and third quarter. Did I get that right, a? And is it material?

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

I'll let Chip talk about the materiality of it, but it's certainly a significant -- we've been working really hard on getting the right messaging and marketing as we've been talking about fairly consistently over the course of the last few quarters. The messaging that we're trying to get out is very clearly to those customers that don't know us, how is -- our produce pricing and our produce freshness is much better than our competition in most markets, and we're trying to emphasize that message alongside the scale of differentiation that we have as a grocer.

So that treasure hunt in the healthy experiential kind of space, putting those 2 messages together, we're just trying to get that -- hone that message and get it where we need to get it. So we delayed some of our marketing because we felt we weren't quite where we needed it to be. And Certainly, in terms of the timing of that, it's a timing issue as opposed to a materiality or numbers. Chip, do you want to add anything?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes, Scott. It's just a couple of million dollars, and it's associated, as Jack said, there's the creative side of that was we thought would be finished in Q1. That's tracking its way into Q2 and some in Q3.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

Okay. That's great. So then kind of to my real question here. I mean, obviously, you guys have done a lot of work with the company. We go in a lot of stores, the execution is good. But you also are having a very different experience than most people in your industry over the last, say, 12 months on the comp line, and there's obviously -- the time will run out where you can comp at 0 and still have good numbers. You're going to start to delever eventually here.

So I guess, #1 is, do you need to do something more radical to kind of get this business moving. You get a lot of cash, financial performance is good. And then the second thing is like is it ever kind of thought of -- Albertson said, we got to do strategic alternatives here? Like do you need to start thinking about that kind of stuff with shareholders in mind, given that we're really struggling to comp and eventually it's going to catch up a bit in the bud?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Scott, we're always going to be taking shareholders in mind in terms of how we think about things going forward. But that's not part of our thinking at the moment. We're very clearly focused on getting is where it needs to be. I'm really encouraged by the traffic growth that we've had in the last 2.

That's the difference in terms of what we've been talking about over the last 12, 18 months or so. We've got ourselves in the last 2 quarters into seeing our traffic growing. And I do think there's some uncertainty in the consumer space that's kind of probably restricted the comp that we would have got. We would have expected to get going forward.

And I think that's reflected in the basket. We're talking a different story here this time around than we have been maybe 2 or 3 quarters ago. And then we're talking about a traffic growth which we hadn't been talking about before, and we're now talking about units in baskets not being where we would like it to be.

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And I think there are some factors that are driving that. We're pretty confident that as that plays through and the uncertainty unravels that what we've got as a proposition in terms of outstanding fresh foods, as you see, great execution in the stores. And that, combined with really telling getting the message through that you'll start to see the kind of comp growth that we're going to have to get to over the next little while.

Operator

Our next question comes from Chuck Grom with Gordon Haskett.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

My question is on the basket again. I'm just wondering if you could remind us where your average basket stands today versus pre-COVID levels. And if you think you can hold on to that level where if you think you have to give some back here over the next couple of years?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

This is Chip, Chuck. I don't know if we've ever actually disclosed the total. We have dollars of the basket.

Susannah Livingston - *Sprouts Farmers Market, Inc. - VP of IR & Treasury*

We've said before, it's $31.

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

So our average dollars in the basket are north of $40 today. So a lot of that over the last couple of years has been on price. So you think about just average units, average cost or price per unit is running the mid-$3. So you're talking 11 to 12 units. So a unit makes a difference for us. Going -- losing 1 unit makes a difference on the downside, but gaining that 1 unit back and controlling it helps on the upside.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Okay. That's helpful. And then, I guess, maybe we could talk about the interplay between that 1% to 2% decline in UPT, which would be at, I guess, about $3 to $6 versus the changes in your AUR that you're seeing at retail. Can we talk about that interplay?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Well, I mean, the changes in retail is in line with inflation over the last couple of years, generally. So we're looking at -- you've been seeing double-digit inflation over the last 2 years.

Charles P. Grom - *Gordon Haskett Research Advisors - MD & Senior Analyst of Retail*

Got it. Okay. Good. And then just last question just on the gross margins. your prior guidance, I believe, was for gross margins for the year to hold. Just wondering how we should think about the gross margin line over the next couple of quarters, given the slight change in guidance that you just provided.

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Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes, the margins are pretty steady. So as Jack indicated, even playing around with price at the item level isn't really driving a reduction or an increase. So there isn't a big -- huge investment in margin. We think it's going to be relatively flat year-over-year. I could actually -- with some shrink savings, we could actually have just a hair up year-over-year, but generally flat.

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

And as we've been talking about around margins over again, the last few quarters, we're fairly confident that the improvements that we made in our margins over the course of the last couple of years are kind of embedded into the model going forward. And certainly, the inflationary environment means we've got to be paying a lot more attention to how we manage our pricing, but we're pretty confident where we're at in our margins. It's something that we can be confident about going forward.

Operator

Our next question comes from Karen Short with Barclays.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

I'm actually wondering if you -- so first question, can you just give us a sense of what actual inflation is as you measure it on cost and retail?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

It's generally in low double digits, Karen.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Both at cost and retail?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. So you're passing on cost, inflation to retail? Just to clarify.

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes, we are. Yes, we are. Yes, we're passing on the cost, inflation.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. And then wondering if you could just give a little color in terms of what your actual mature stores are doing from a comp basis. And we talked about this before, but obviously, you have a waterfall benefit on your comp and with your unit growth. So that doesn't seem to be flowing into

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your comp currently, but wondering if you could just give a little color on how that -- how your mature stores are comping versus your newer and an update on the waterfall benefit?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes, I can provide some. So we actually, in the first quarter, started to see some more material benefits from our vintages of stores I go back to, call it, 2020. So we're getting double-digit comps from our 2020 vintage. We're getting call it, mid-single digits from our 2019 and then 2018 and before, it kind of mixes into the comp. 2021, of course, they're not comping yet.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. And then last question just for me. So you're basically -- you are seeing pushback from customers on inflation. That's fair to say, right? Because you're seeing that in I guess, average unit volume? How do you feel about that?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes, we are seeing less units going into the basket. Is it because they're pushing back, because they don't like the price of the unit. Are they pushing back because they're spending their discretionary dollars somewhere else, such as restaurants, experiential places that we see happening between restaurants, travel, et cetera. But at the end of the day, they are deciding that I only want to spend so much on a basket, and we play with testing.

We test -- I mean, play with pricing all the time and test it. And there's not -- it's not driving incremental demand just through price. And if you look at -- when we look at it, we're looking at survey data, too, that would suggest that others are having the same unit in the basket issues or challenges, maybe different magnitudes. And when we look at comp even comp guidance in the industry and you look at double-digit inflation and you look at single-digit comps, either the industry is experiencing less traffic or less units in the basket. It has to be 1 or the other.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

And how do you see that playing out throughout the year as it relates to your guidance?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes. It's in our guidance. As we said at the beginning, or we were going to get to a place where we were comping that from a year-over-year perspective. And our expectations were as inflation would start to subside beginning in the second quarter, just from a year-over-year perspective and the units stabilized. But what we're seeing is inflation is continuing to quarter-to-quarter-to-quarter is still higher year-over-year. And with that, the industry is seeing less units going to the basket.

Operator

Our next question comes from Edward Kelly with Wells Fargo.

Edward Joseph Kelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

I guess my first question really is probably sort of similar to what you've heard from others here. I'm just trying to better understand the momentum of your business versus sort of like what we're seeing in at some of your conventional peers. Because I understand this debate around they're seeing less items in the basket. But the reality is, like if we sit here and we look at sort of like comp sales versus '19 in your business versus others, I mean it's dramatically different.

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And now you're talking about elasticity, and we're not picking up, and we're not really hearing that from others. So I'm just -- do you think that there's something incrementally specific that's happening to your business in Q1 that's causing this underlying deceleration? Or do you think you're just one of the first to really kind of start to sound the alarm bell on just too much pressure out there on consumer?

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

Well, I don't know how to characterize what everyone else is going through, but we know exactly what's happening in our business. We've seen double-digit cost inflation. We're passing that on in double-digit retail inflation. You've clearly got a lot of pressure on the consumer, right away across the economy, whether it be gas prices or spending money on restaurants or spending money in transportation as people emerge from the pandemic.

The uncertainty of supply chain, costs and inflation has clearly been having an impact on the economy. So what is that doing to our business. We're really confident about the fact that our traffic is growing in the context of this environment. That's something that we've been talking to you all about and talking to the community about fairly consistently. We're encouraged by that to see a positive transactions in our business. We actually think that will continue. We think the proposition that we have. We're not a conventional grocer. We're not trading from a conventional grocer to a specialty grocer.

We are doubling down on being a specialty grocer that has exceptional fresh foods exceptional pricing and very differentiated product that focuses in on attributes, whether it be keto or paleo or vegan or vegetarian all of that is coming together really strongly. And I think that's 1 of the reasons traffic is getting a little bit better.

And I think as we continue to get that message. In that context, when people are coming into the stores, what we are seeing is that they're buying 1 or 2 units less. We think we can do a lot about that within our own control despite the world that's going on around us. We think there's things we can do, whether it be improving installed, getting a bit more of a buzz inside our stores. I think grocers did an amazing job through the pandemic as we did, but we inevitably became less farmers market feel because people aren't able to drive excitement in the store when you come in and do sampling and taste some of the products and get some of the new products into people's mouths, we see that as a significant opportunity for us to drive that basket back.

And we don't need much for this thing to come right when you're operating on positive traffic. So that's why we're confident about our own business. It's difficult for me to characterize what's happening elsewhere. But clearly, there's pressure, and it looks to me like there's less units going into everybody's baskets.

Edward Joseph Kelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

And then maybe just a follow-up, and I guess it's kind of related, but Jack you talked about how you're confident that the margin sort of stays where it is currently. And obviously, that's the way you're guiding this year. The iTest on gross margins up a lot over the last few years and the comp where it is today is not great. So I'm just kind of curious as to where the confidence around that comes from? Because I think my concern, and probably a lot of others, is just around sort of like the over-earning argument on the margin. And just kind of curious as to updated thoughts there.

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

Yes. Well, again, we believe there's traffic opportunities. We know exactly the number of customers that are out there in the country that look like the customers that love Sprouts. And if we can attract them, there's plenty of traffic to drive what we need to drive in terms of our numbers. And then with regard to our margins, we've tried a little while, we've done various things.

And when I came in, we were doing very aggressive pricing that, that context when you are a specialty grocer, you've got a proposition that's relevant for the customers. And if all you're doing is attracting people who are coupon clippers, who are going to trade with you because somebody else -- you've got a lower price than someone else. It's a transient thing. You don't build long-term loyalty behind it.

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So we've tried it, we've tried pricing. It doesn't actually work for us. The elasticity that comes with it takes margin out, actually, in some ways, take some of your top line sales away as well. So we're very much on the path of creating a better return specialty grocer, the kind of comp sales that's going to drive long-term success for our shareholders and our team.

Operator

Our next question comes from Krisztina Katai with Deutsche Bank.

Krisztina Katai - *Deutsche Bank AG, Research Division - Research Associate*

I just wanted to follow up on the same topic as it relates to unit elasticity. Could you maybe elaborate on that if there's any specific categories where the decline is happening? And I think your average consumer is slightly higher end than conventional grocers, but I guess you're the first one to really see this. And I guess my question is, have you noticed any changes in patterns within your various income demographics that would point to trade down happening?

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

We haven't really got a perspective on that directly. As we look through the categories. We're seeing certainly prepared meals, seen as a strength for us. Vitamins are seen as a strength for us. So -- and grocery has been quite strong given the proposition that we're putting in place. So by and -- so into that, the other parts have not been as strong as that going forward. So maybe our core meat and produce business isn't as strong as some of the other parts of our position at the moment. And that might certainly in our meat business, maybe there's an element of the price, the value of that.

You're seeing some trading down in that space as people look to kind of try and conserve some of the dollars as they go into the center of plate kind of purchases. I don't know if you get another perspective on that. But that's kind of -- that would be our perspective. I don't think we're seeing a dramatic change in trade down. Again, we're seeing some positive traffic, which is quite encouraging in the middle of all of this.

Krisztina Katai - *Deutsche Bank AG, Research Division - Research Associate*

Got it. That's helpful. And I guess I just wanted to circle up on pricing. Maybe if you could just talk about your assortment, how that is resonating in the current environment. If -- do you think there's any changes that you might need to make to drive positive comps, the traffic is there, but just to get the total comps to be positive in this environment. And I guess if you could just talk about your current price gaps in key categories like produce, meat and frozen.

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

Yes. Well, we've talked a lot about pricing. Produce pricing is very important to our business. So we look to have against most major conventional competitors, which is the only place we can compare. Produce is really the only place where we sell the same things as other people. We're looking for a 10% to 15% price gap against most conventional -- you won't see the same thing against Walmart. But we're out looking at a price gap even against Walmart in our produce business.

When you look at the other categories, we'll look at last our meat business, we tend to skew to higher specification products in our meat. So we're not directly comparing when you've got grass-fed, and you've got antibiotic-free and those kind of things. We're not directly comparing in meat. So we don't look at that quite as much as a direct comparison because we don't operate the OPP as they call it in that space to the same extent as the other players. When it comes to our frozen business, I think 96% of what we sell in frozen, you can't find in a conventional supermarket. This whole range of plant-based in keto and palio and dairy free, and we're that category, we look at elasticity.

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We look at what's happening to pricing, and we've got a model that says, what happens to volume when we change prices in that. And the same is true across our grocery business. Maybe the areas on pricing that I've got some kind of concern as we look at it is the vitamin space, is our vitamin pricing against people like Costco and Amazon, where it needs to be. But we're looking at that. There's certainly some good margin in that space that might allow us in a little bit of space. Across the board, product gaps are the ones that are the most important one. The rest of the business will look at elasticity.

Operator

Your next question comes from Rupesh Parikh with Oppenheimer.

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

So I just wanted to go back to the full year comp guidance, which I believe it now implies flat comp guidance for the full year. So I think based on all the commentary you guys provided so far, inflation plus transactions plus the comp waterfall, I think would be more than offset by fewer units in the basket. I think that gets you to a negative territory. Is that the right way to think about that?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes. That's absolutely correct, Rupesh. And it's -- I mean, it's plus or minus, right? We guided to the low end 0 for the year. We had a 1.6% in the first quarter. So right now going forward, it could be slightly negative, slightly positive. That's why we're kind of pushing towards the low end of our guidance. And you got to make up -- our assumptions on the makeup is exactly what you just said.

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Okay. And then quarter-to-date, I think the 0% comp, is that essentially what you're seeing right now in your business?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Well, considering our guidance, we've been taking into account how we're doing quarter-to-date. How about that?

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Okay. That's helpful. And then maybe my last question, just in terms of the new store format, you've opened more locations, you've seen your new store format, I guess, continue to ramp. How do those stores continue to perform versus your expectations?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Well, we can't declare victory yet because we've only really got 5 of them on the ground. We've got 1 in Florida, 1 in Georgia, 1 in Texas, 1 in California and 1 in Arizona and some more mature than others. We're very encouraged by the first 2 that we've done. They have been there on the ground longest. The next 2 are encouraging. It's too early to say. But the program is going forward. The great thing about it for us is we're seeing higher sales per square foot, fairly significant higher sales per square foot than what we call the V5.

So the sales per square foot that we're getting in the V6s, which are 23,000 square foot as opposed to the D5s, which we were building at 32,000 square foot is seeing a very significant increase. So we're really encouraged by categories like Deli, which we've taken the space and the cost down fairly substantially, and we're getting exactly the same sales from them. So that's encouraging in terms of the returns.

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And the risk to returns is that we've got significantly lower costs. And I'm glad we did it given all the pressures that we've had on cost of building stores over the last year. I'm really glad we did that because we've been in a difficult position if we hadn't done that.

So, so far, we're very encouraged. There's going to be some tweaks that we're going to make to try and get it right because it's always an extractive process when you're developing new formats. But we're encouraged by where it's at, and it's certainly something that we are doubling down on this year.

Operator

Our next question comes from Ken Goldman with JPMorgan.

Thomas Hinsdale Palmer - *JPMorgan Chase & Co, Research Division - Analyst*

It's Tom Palmer on for Ken. I think you mentioned fresh categories as being a bit weaker than some others when talking about the basket composition for me, maybe it's the inflation, but what about for produce? I mean we do have a drought coming on pretty severely in California. Is that having any bearing on produce availability or quality? Would you attribute maybe the relative produce weakness to something else?

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

Well, I think our challenge on produce is actually more about in stock, not too much sourcing. It's about how we flow the goods into the store, which we've got -- I think we said in Chip's remarks or my remarks, we talked a lot about how we're investing in technology to try and make it easier for the stores to get in stock the way we want to do.

There have been some supply challenges, but we're doubling down on prudent investment to make sure we're in stock of the right quality product as fresh as we can be. We're seeing better performance, for example, in our Colorado business, where we've seen -- where we've built our distribution center closer to the stores. We're seeing a little bit better performance in our Florida business because we've built the distribution center closer to the stores.

So our focus very much is on freshness and in stock and our produce business. And we anticipate that, that's going to help us drive through. But certainly, the pricing have an impact there as it's gone up as pricing has gone up in that space. And we're having to watch that carefully at the moment.

Thomas Hinsdale Palmer - *JPMorgan Chase & Co, Research Division - Analyst*

Okay. And then just wanted to ask on the store pipeline that you're seeing, had some later 2022 projects delayed into 2023. Are you starting to get enough visibility for 2023 to say that's going to be an on-algorithm growth here in terms of units?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

We have a site now. I think it's going to be pretty close. We should be able to get close to the high single digit, maybe double-digit growth next year as we get there. We had this bubble that we are trying to catch up to then right about the time as the supply chain got challenged. But by pushing some of those stores out of '22 into '23 and just the way we were catching up, I think we're going to be in a pretty good place by '23 to be close to our 10% target.

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

And we're very encouraged by the pipeline of stores that we've got coming from '24, '25. So there's a lot of confidence that this thing will sort itself out, but we've had clearly some construction challenges and permitting challenges this year. But I'm pretty clear 2023, 2024 is going to be back on track.

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

And 1 other -- I'll add an item. In '23, the focus to is to really try to get to a place where we're consistently building or opening by quarter as opposed to it all being showed towards the end of the year. It's much better for operations. We're getting ahead of that now. So I think we're going to be in good shape in '23 from a new store perspective.

Operator

Our next question comes from Robby Ohmes with Bank of America.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD & Senior US Consumer Analyst*

I've got just a few quick follow-ups. The first one, just you mentioned the Chip, the gross margin being stable. Anything on labor costs or SG&A that we should be thinking about to get to the low end of your guidance range for the year?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

No. I mean labor costs, obviously, labor costs are creeping up. We're able to -- we have been able to manage through that. We just recently were put -- we put a system in place and process in place, we went through labor standards. So we're really good from a labor standards perspective. So the cost, I'm anticipating the full year cost to be probably all in for SG&A will probably be up around, call it, 6 percent-ish for the full year. So it's still a little bit lower than our top line total growth. I mean it's a little bit higher. So there's some -- there's a little bit of deleverage there, which is to the point earlier that someone made about trying to get the comps higher.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD & Senior US Consumer Analyst*

That's helpful. And then can you remind us, Easter is not so important for you guys, right? And so there's no real Easter shift between quarters?

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

No, not really. I mean the Easter, it's -- we're open on Easter. So that's for starters. Certainly, it was like a 1-week move. So we are a little bit better business on this year when it wasn't Easter and a little less business on Easter than we had year-over-year, but it's not material.

Robert Frederick Ohmes - *BofA Securities, Research Division - MD & Senior US Consumer Analyst*

And then my last question is just inflation has been surprising you. The -- what are you guys thinking inflation is? Would you think it could run double digit for the rest of the year?

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Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Yes, we think so. I mean everything that's pointing -- everything seems to be pointed in that direction, not what we thought early in the year. We thought we'd start to year-over-year when you just looked at it, you started to think that you'd start to -- by the second -- this quarter, around this time, you start to see it trailing off because you're comping against big numbers the year before.

We'd probably be in the high single digits. And by we got -- by the time we got to the back end of the year, we expect the inflation to be pretty normalized year-over-year and be, call it, lower than mid-single digits. What we're seeing now is we're continuing to see cost increases flow through. And our line of sight right now would suggest that as you think about the full year, it's probably going to be minimum high single digits, if not low double digits.

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

I don't think the Fed are thinking there's going to be any significant reduction in inflation really through the end of the year as but some of the pressures on food pricing that's going to come from the from the conflict of Russia and Ukraine thing, which I think will have an impact on fertilizers, impact on food pricing. I think it's appropriate for us now to think inflation is going to get much better.

Operator

Thank you. Our nice question comes from John Heinbockel with Guggenheim.

John Edward Heinbockel - *Guggenheim Securities, LLC, Research Division - Analyst*

So Jack, what do you think you need to do to improve the selling culture that you referenced? And what happened to -- well, I was going to say as a part of that, what's happened to department manager and employee turnover. Has that been a part of that?

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

I think what happened, and I think it was logical what happened in our business in that through the 2 years of the pandemic, we actually turned off a lot of the magic that really got Sprouts moving in the first place.

We're back to the early days. This idea of creating a selling culture inside the store. I think that was part of the DNA of the company. And I think the pandemic kind of took a bit of that away simply because we were spending all our time learning about cleaning things and protecting people and wearing gloves and wearing masks and people were frightened to kind of approach people with some of the fresh products that we have.

And that culture when you walk around a firm farmers market of casting thing and having people walking around the store. We have a few people in our stores who are great at that. And I think we can reignite that. And it's only now that we're able to even have that conversation. That's not been something that we've been comfortable with, with the -- what we're talking about and then Omicron and we kind of had to put a lot of that stuff on hold.

So the big thing for me on this is reigniting that kind of DNA that exists in our company. And if we can get the store managers thinking about just selling a few more units, had a really good experience in a store yesterday where the store manager and his team were just bombarding me with ideas as to how they're going to sell more units of this and more units of that.

Getting that culture into the organization, we've been just trying to serve our customers and serve our communities over the last couple of years. And I think -- if you're interested in your health, that's been a good thing for us.

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So to me, it's very much, John, about just reigniting that DNA, and we are appropriate for that, we're appropriate to be able to do that. And you can think of -- and I'm encouraged by even the way people are talking about it already.

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

And John, I would add on to follow on a little bit is, I think in this industry for starters, but even specifically here, we thought about basket, basket, basket and dollars, and we think about sales. But when you start to talk about the actual makeup and you start to talk about the units, it's such a more tangible thing to try to coach your store associates of get that extra unit, drive the extra unit. It's much more tangible than saying basket because they don't have immediate visibility to what the basket is, they can kind of look at what you got in your basket.

This is just -- it's much more tangible. It's a selling culture that Jack and I have -- as we've talked to other, call it, smaller businesses across the country who are in similar spaces, some of them are really good at that, and it creates it where the associate knows exactly how many units are being -- are coming off a certain fixture. So that's the culture shift. So it's not just going from where we were in '19 or '20, pre-pandemic, to where -- to getting back to that. On top of that, there are other opportunities, we think, to drive more units in the basket culturally.

John Edward Heinbockel - *Guggenheim Securities, LLC, Research Division - Analyst*

And just maybe as a follow-up to that. Do you think not having fuel rewards hurts you, right, relative to others? And is that just something you're going to have to live with right? Or is there a way to address that maybe partnerships with fuel providers.

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

We've never had it. So I don't know if it's hurting I was not having it or having it. I don't see -- it's certainly a legitimate question in terms of the context of what's happening with gas pricing in the marketplace. I think I'd like to take that in a way of a really good thing about it.

Operator

Our next question comes from Chuck Cerankosky with Northcoast Research.

Charles Edward Cerankosky - *Northcoast Research Partners, LLC - MD of Research, Equity Research Analyst & Principal*

Got a question with regard to the unit sales. And I sense perhaps a conundrum here. You've got supply chain that sometimes is not getting -- allowing you to get product on the shelf. But you've also mentioned you want to do a better job of ordering and managing what's on the shelf plus a lot of new products. Are you fighting your own objectives here by changing too much when you're not ordering as optimally as you'd like while at the same time, it's just tough to get the products that were already in the catalog.

Lawrence P. Molloy - *Sprouts Farmers Market, Inc. - CFO & Treasurer*

Chuck, it's Chip. And when we talk about in-stocks, the company historically has been what I would call less than optimal. There's always kind of been this hanging opportunity from in-stocks. Did COVID complicate it a little bit more? Yes, it has, not nearly as material as it has affected some of the conventionals over time, we believe. But this opportunity to improve our in-stocks 400 or 500 basis points is one that we've been laser -- we've gotten more laser focused on in the last year because we decided to make that investment in a system.

We've decided to make that investment in the training of that system in our stores. It's something that it's not like an immediate thing we just started because we want to just drive units in the basket. That's been an ongoing effort.

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We've made the investment. We're doing the training. We're implementing it now, and it's -- we think that, that's very critical for us as a release. When you ask the question is that a lot of things going on when we're bringing in more products and yes, we're going to challenge ourselves. We're challenging ourselves now on the number of products we bring it all the time and just making sure that we don't want to lose that innovation, we're not going to lose that innovation.

We're going to continue to bring in great products. Some of our products have a long tail on that. So we have we have to be better about how to manage that longer tail, and we're working on that as well. So in stocks is probably one of the -- it's one of the more critical, if not the most critical thing we're working on behind the scenes to help run a better business and not give up innovation at all. So that's -- hopefully, that answers your question.

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

And I'll just add. The key to our business is being appropriately differentiated for health enthusiast customers and innovation seekers, that's what we've set out as our real estate strategies, our merchandising strategy, it's our marketing strategy, it's how do we target those customers. And if we lose -- an innovation is the key to that going forward, and I think it's within our capabilities to manage the differentiation and manage the change that, that brings because that's ultimately what's going to make us win long term.

Charles Edward Cerankosky - *Northcoast Research Partners, LLC - MD of Research, Equity Research Analyst & Principal*

And as part of that, Jack and Chip, doing better in the meat and produce, or call it the protein and produce categories than the rest of the store.

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

Yes. I think it's really interesting to me that when you -- the local business in produce is so important to us, where you actually source and buy product locally and the DC network will allow us to do that, and that's part of differentiation, getting that right, building varieties of products that take us to a level of taste and quality that's different.

Produce's got a huge opportunity, and we're doubling down on that. Our organic produce business is now 35% of our overall produce business. That's pretty substantial. And that whole context of being different, it's kind of coming alive even in categories like produce. And in the meat department, it's very much about how do you create different attributes that are different to what other people are selling in the conventional space. And every department we're looking at, we're doubling down on that.

Operator

And that concludes our Q&A session. I would now like to turn the call back over to Jack Sinclair for any closing remarks.

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

Well, thanks, everyone, for your interest in our business and your questions, they help us think about our business. So I appreciate those questions, and stay safe everyone. It's nice to spend some time with you.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.

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