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PRESENTATION

Operator

Thank you for standing by, and welcome to the Sprouts Farmers Market Second Quarter 2023 Earnings Conference Call. (Operator Instructions) As a reminder, today's program is being recorded.

And now I'd like to introduce your host for today's program, Susannah Livingston, Vice President of Investor Relations and Treasurer. Please go ahead.

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

Thank you, and good afternoon, everyone. We are pleased you are taking the time to join Sprouts on our second quarter 2023 earnings call. Jack Sinclair, Chief Executive Officer; and Chip Molloy, Chief Financial Officer, are with me today.

The earnings release announcing our second quarter 2023 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 2023 and beyond. These statements involve several risks and uncertainties that could cause results to differ materially from those described in the forward-looking statements. For more information, please refer to the risk factors discussed in our SEC filings and the commentary on forward-looking statements at the end of our earnings release.

Our remarks today include references to non-GAAP measures. Please see the tables in our earnings release to reconcile our non-GAAP measures to the comparable GAAP figures. With that, let me hand it over to Jack.

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

Thanks, Susannah, and good afternoon, everyone. I'm pleased to announce another solid quarter for Sprouts Farmers Market. Our 31,000 team members delivered comparable store sales growth of 3.2%, total sales growth of 6% and adjusted earnings per share growth of 25% in the second quarter. Their efforts to provide a unique in-store and online experience, differentiated products and superior customer service all continue to establish Sprouts as a go-to healthy specialty food retailer.

During the quarter, we opened 6 new stores and are on a path to open at least 30 for the full year, allowing us to profitably expand our reach to new health enthusiasts and innovation-seeking customers. During the quarter, we also relocated our Southern California distribution center to a new larger facility, and we simultaneously expanded our tech with DC. These distribution centers will allow us to bring fresher products to our customer base while providing capacity for growth in those markets for years to come.

In a moment, I'd like to turn it over to Chip, who will provide a closer look at our second quarter financial performance and our outlook for the remainder of the year. Before doing so, I want to take a few moments to thank Chip for his 10-plus years of service to Sprouts. As you may have seen in our release this afternoon, Chip has decided to retire at the end of this year. Chip has been a tremendous asset as a member of our Board and executive leadership team. And on a personal basis, I have valued and enjoyed our partnership.

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

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

Thanks, Jack, and good afternoon, everyone. For the second quarter, total sales were \$1.7 billion, up \$97 million or 6% from the same period in 2022. This increase was driven by adding new stores, combined with comparable store sales growth of 3.2%. We experienced positive comp transactions, our proxy for traffic throughout the quarter, combined with a net increase in basket. The basket increase was similar to the last several quarters, where the increase in retail inflation was partially offset by a slight decrease in the number of items in the basket from a year-over-year perspective.

As expected, moving into the third quarter, we are beginning to see a slight tapering of both the year-over-year price inflation and the unit declines. Our e-commerce sales grew 16% during the quarter, representing 12.1% of our total sales. Our new markets continue to show encouraging trends, driven by density of stores and increased brand awareness. On the product front, our strongest performing categories remain the ones with the most differentiation such as grocery, bakery, dairy and proteins, further supporting our strategic decision to focus on these key departments important to the Sprouts customer. Our private label or Sprouts brand sales grew 12% and represented 20% of total sales as innovation seekers value uniqueness and quality only to be found at Sprouts.

Turning to gross margin. Second quarter gross margin was 37%. Excluding the impact of special items, adjusted gross margin was 37.1%, an increase of approximately 70 basis points compared to last year. Category mix shifts and continued promotional optimization contributed to the secretion. SG&A for the quarter totaled \$498 million. Excluding the impact of special items, adjusted SG&A totaled \$494 million, an increase of \$32 million from the same period in 2022. This increase was primarily driven by the addition of new stores and higher e-commerce fees. Like many other retailers, over the last several quarters, we have been experiencing rising labor costs. More recently, we've also invested in a more engaging store bonus program and additional labor hours for sampling to support the business' long-term growth. To date, our operations and information technology teams have done a remarkable job of offsetting those increases with new processes and technologies while enhancing the customer experience. Examples include the implementation of FIM or Fresh Item Management, a new labor management system, installation of self-checkouts and more efficient sequencing of professional tags.

Store closures and other costs totaled approximately \$2 million for the quarter, while depreciation and amortization, exclusive of the depreciation included in cost of sales was \$34 million for the quarter. Excluding special items associated with our store closure decision in the prior quarter, the adjusted depreciation and amortization totaled \$32 million.

For the quarter, our earnings before interest and taxes were \$92 million, while interest expense was \$2 million. Net income was \$67 million and diluted earnings per share were \$0.65. Excluding the impact of special items, adjusted earnings before interest and taxes were \$100 million and adjusted net income was \$73 million. Adjusted diluted earnings per share were \$0.71, an increase of 25% compared to the same quarter in the prior year.

Now let's turn to our cash flow and balance sheet, which remains robust and strong. During the second quarter, our cash generation allowed us to first and foremost, invest in our business, including opening 6 new stores, the new distribution center, expanding a distribution center and investment in convenience meal fixtures. In total, we spent \$48 million in capital expenditures net of landlord reimbursement. We also paid down \$50 million of our bank revolver and returned \$50 million to our owners by repurchasing 1.4 million shares. We ended the second quarter with [\$259 million] (corrected by company after the call) in cash and cash equivalents, \$175 million outstanding on our \$700 million revolver and \$22 million of outstanding letters of credit.

As we evaluate our expectations for the remainder of the year, we continue to monitor consumer spending and behaviors in a dynamic environment and focus on controlling what we can control. For the full year, we continue to expect sales growth in the range of 5% to 6% and comp sales growth of 2% to 3%. We expect gross margins to be slightly up and a slight deleverage in SG&A due predominantly to the acceleration of new store growth and rising labor costs. The deleverage will be a bit more in third quarter, mainly due to timing shifts we mentioned last quarter. We are raising expected adjusted earnings before interest and taxes to be between \$378 million and \$390 million and adjusted earnings per share to be between \$2.68 and \$2.76, which assumes no additional share repurchases. That said, we do expect to continue to repurchase shares opportunistically.

As Jack mentioned in his opening remarks, we're on track to open at least 30 new stores this year, all of which are in our current prototype. Capital expenditures net of landlord reimbursements should be between \$190 million and \$210 million. For the third quarter, we expect comp sales of low single digits and adjusted earnings per share between \$0.59 and \$0.63.

With that, let me turn it back to Jack. Jack?

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

Thanks, Chip. We continue to be encouraged by our performance to date, driven by the strategic changes we've made over the past few years. Our differentiated products are resonating with our core customer segments. Supply chain continues to get stronger and more efficient. We are accelerating our store growth with our new prototype. We are improving customer experience, both in-store and online and slowly but surely connecting more effectively with current and potential customers.

As I have mentioned many times, we are a specialty food retailer. We curate products that contain attributes appealing to the health enthusiast customer. For example, in proteins, more than 50% of our beef sales are grass-fed, more than 50% of our chicken sales are organic and 90% of our grocery sales have specific diet attributes such as vegan and non-GMO. Even in produce, which many consider a commodity, over 40% of our sales are organic. This is a significant difference from other grocers.

Our innovation seekers are also finding a treasure trove of products from locally sourced produce to our private label Sprouts brand. In the second quarter, we focused on our seasonal produce assortments in each region and shared the local grower stories in store. For the second quarter, approximately 19% of our produce sales were from local farms.

As Chip mentioned, Sprouts brand continues to be a growth driver for us with penetration over 20% this year. We have driven the brand through active sampling, e-commerce and store merchandising improvements and redesigned packaging. Our team has released over 200 new Sprouts brand items this year, focusing on relevant taste profiles and health attributes. We were honored this year to receive many Vertex awards, including

Retailer of the Year and several gold, silver and bronze awards for our curated products. We're eliminating the guest work of finding healthy alternatives because differentiated healthy options are who we are and what we sell.

As I mentioned earlier, during the second quarter, we were busy improving our supply chain. We successfully opened our new larger Southern California DC in Fullerton in May and closed the Colton, California DC that we outgrew in late June. We doubled the size of our Texas DC and added ripening capabilities in our Texas and Arizona DCs. These expansions grew our DC square footage by approximately 40%. Coupled with our recently opened DC in Colorado and Florida, these expansions allow us to support our 10% store growth while improving our produce quality and freshness.

As for unit growth, our smaller, most cost-effective format continues to roll out. We opened 6 new stores in the second quarter, bringing us to 14 new stores year-to-date, all in the new prototype. Our pipeline is also growing with nearly 100 approved new stores and more than 60 executed leases, helping us gain traction towards our goal of 10% unit growth per year, starting in 2024.

Our recent vintages continue to perform as expected as we focus on great store locations, increasing our marketing reach for greater awareness and highlighting our unique attribute-driven products both in and out of store.

We continue to work on our omnichannel experience. As I have mentioned, we rolled out a more active sampling program that helps support trial and basket growth of our unique and healthy offerings, including Sprouts brand products. And while our enhanced customer service program is just off the ground, we're seeing scores for in-store satisfaction improve beyond our early goals.

Online, we are pleased with the sales and customer growth in all 3 of our channels: Instacart, DoorDash and our own shop.sprouts.com. Over the last several quarters, we've significantly enhanced our e-commerce platforms, including a site redesign and optimized search functionality to create a more personalized and relevant customer experience with improved product shopping, a menu redesign and rolling out a shoppable flyer. Communicating and connecting with customers more effectively continues to be a top priority and the opportunity for Sprouts. Almost 80% of our media is now spent on digital, aimed at driving more shopping occasions with our target customers and supported by data-driven plans.

Our Find Your Healthy creative campaign is evolving to use more enticing food photography to communicate freshness and move away from animations. Our new creative approach is designed to work in tandem with our digital media plan that focuses on each stage of the customer journey. As we all know, linking transactions with individual customers provides valuable data and better insights into their needs and wants. We are still in the test and learn phase with our personalization efforts. These learnings are helping to guide our thinking as we build towards a more robust and relevant loyalty program. This is a multiyear journey that we believe could provide significant future benefits.

In summary, we believe we're making progress in growing our business and establishing our brand as the healthy specialty retailer of choice in a challenging macro environment. That said, there is more work to do to capture the opportunities in front of us. Fortunately, we have a talented team in place and are well positioned to succeed and grow.

With that, I'd like to turn it over for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Ken Goldman from JPMorgan.

Kenneth B. Goldman - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Chip, congrats on your pending retirement. I was curious, it's typically when a retirement is announced, the company will either announce a successor or at least will say that a search is underway. In this case, the phrasing was that a search will take place. I just didn't know if that's indicative

of any element of suddenness or anything we should think about in terms of the timing? I assume there's nothing there. I just wanted to ask and make sure.

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

No, absolutely, Ken. The search is underway. We should have been clearer enough. Actually, we didn't express it like that because there is a search underway. And it's not at all -- it's not a suddenness at all. We've been thinking about this for some time. Chip has been thinking about it some time. I don't know if you want to say something, Chip.

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

Yes, Ken. This is -- it's been planned for a while in my head, and timing is right, and it's been a great run here. And the near 10-plus years, and that's just -- I'm ready to go out to pasture finally. I've tried to retire a couple of other times, I failed miserably. But this time, I think I'm good to go.

Kenneth B. Goldman - *JPMorgan Chase & Co, Research Division - Senior Analyst*

You've been there during an interesting 10 years. So congrats to you.

I just wanted to also ask the competitive environment certainly still seems from what we can tell to be rational. Clearly, there's a bit more promoting going on, seems to be paid for mostly by the vendors, the manufacturers. Just wanted to get a little bit of a broader sense for how you see that for the rest of the year, what you're factoring into your guidance? And if you would agree that it's still within the boundaries of what you might consider rational, if that's the case?

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

Yes. I think that you described it exactly right, Ken. The context of our -- the competitive dynamic doesn't seem to be changing dramatically. And certainly, we're in a slightly different place and a lot of the things that we sell are very different to what -- how you would describe that competitor dynamic. So we're watching it. We watch our produce pricing very carefully, and we're in good shape on that. And we're not seeing a lot of things that cause that gives us cause for kind of any concern in that space.

Operator

And our next question comes from the line of Leah Jordan from Goldman Sachs.

Leah Dianne Jordan - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I just want to touch in on volumes. You said that they were improving sequentially, but still in decline. Just any color on the magnitude of how that's improving there? And then should we think that it's coming back from the produce side? Is that where the challenge was last year? Or just can you talk about how the trends in fresh and produce overall are to the total store decline?

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

Yes, Leah, this is Chip. So overall, we're seeing -- as we expected, and all honestly, last year, we expected it too, but then the Ukraine incident happened. But we expected at the beginning of the year that as the year would progress, there will be less top line benefit associated with AUR and that the units per basket would start to stabilize, so you get less negative impact year-over-year. We're beginning -- starting to see it late in the quarter and beginning to see it in the third quarter where it's happening just as we thought. You're seeing less benefit from AUR, and you're

starting to see it stabilize sequentially. And the same thing for units, you're beginning to see less negative for units, and it's beginning to stabilize and it's just starting to get to that number slightly under 10, and that's where we're hanging out units per basket.

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

And regarding the fresh side of the question, Leah, certain areas like meat, we have seen a slowdown in the rate of inflation, and we've also seen an encouraging change in terms of the unit volume that's been going through on that. So the way Chip described it almost 18 months ago now, how that's playing through is how we're expecting it to play through going forward. You're seeing a little bit of reduction in terms of the pace of inflation, not going into a negative, but the pace of inflation is slowing down and the dilution in units is changing. But in volatile categories like avocados, you're seeing some pretty dramatic changes in that where the pricing changes, and you see a pretty immediate change in unit volume. So we'll watch it closely. We're in a very -- produce is a big part of our business, as you know. So we watch that, and there's always been volatility in produce, and that remains the case.

Leah Dianne Jordan - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Okay. Great. And just on my follow-up, I wanted to check in on the 3Q comp guide. The low single digit is just a bit more vague than you guys typically give. So curious if you're seeing anything different behavior-wise from the consumer? Or is that more just a function of maybe uncertainty on the disinflation outlook? So any color there and maybe some quarter-to-date color as well.

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

Yes. We -- it's a little less, it's a little wider. Obviously, those signals can be 1 to 3-ish. We feel solid about that. And how that unit versus AUR and how it transpires through the quarter is, I would say it's fragile how it fundamentally comes out. But right now, we feel really comfortable that we're going to be in that range.

Operator

And our next question comes from the line of John Heinbockel from Guggenheim.

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

Jack, can you dive into the 2 target customer segments. In terms of growth in new households, right, of that group and any insight you have on wallet share. I'm just curious how they're performing relative to the overall base in terms of the acquisition and how much of their wallet do you think you have today?

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

Well, we've got a low percentage of the wallet, which we always had in terms of the health enthusiast and the innovation seekers. The encouraging thing that when I look at data about natural and organic, which is the kind of -- which we can get very good data on in terms of our market share. Market share is encouragingly growing within that space and significantly different to the kind of the more traditional products that we have. So our business is continuing to focus on differentiation so that we can attract and appeal to a small share growth that we need from those target customers. And we're seeing some encouraging market share data in the last little while. I'm very encouraged by the traffic that's coming in and the traffic's coming in both digitally, both e-commerce and in bricks and mortar. So we're seeing a nice balance of both -- so we're creating this omnichannel customer who's very in tune with the curated assortment that we've got and the data that I have got, and we'll get more data going forward, but the data that we've got so far suggests that we're growing share with those target customers, which has always been the intent since we really pivoted the strategy around this target customer base.

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

Well, so when you say low single digit, right, that your share of the market as opposed to your share of individual customers' wallets. I know you don't have a loyalty program. But I'm just curious, right, with your best customers, what percent of their wallet do you think you're getting in food? Is it 15% or 20% or not that high?

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

No, I'd say it's relatively low. I don't have the exact number. And that's why the opportunity is so big in front of us. We don't need much of a growth to make the numbers really add up over the next few years, and that's why we're so confident of where the strategies are. We've got a low share of our customers' wallet, which is the nature of our assortment. We've said all along that we're not going to try and win on conventional products with conventional grocers. We're going to win on the differentiated assortment that we have. And that -- on the basis of what we're looking at, at the moment, that's moving in the right direction, and we continue to have confidence that the growth in share of wallet that we will get with those target customers are more than fulfill our long-term plans.

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

All right. And then just lastly, you think you'll have a loyalty program and it'll probably be more affinity than loyalty. But when do you think you'll have something out there in the next 12 months or longer you think?

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

We're working very hard on this, and it will evolve and develop. And I don't think you're going to wake up one day and have it exactly the way we want to have it. We will -- we're getting more data from our customers. We'll increasingly get more data from our customers. And what we then do with that, we're in the process of figuring that one out and exactly how it manifests itself and how it plays into the marketplace, we'll certainly be in a better position to know exactly where we are next year on this one.

Operator

And our next question comes from the line of Mark Carden from UBS.

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

Chip, congratulations on the retirement. So another strong comp, and it seems like you're seeing some nice market share gains. When you think about your store base, are you seeing much of a deviation in results between your newer markets and your legacy markets? You guys talked about improving brand awareness. Are you near where you want to be from a recognition perspective in some of your newer markets? Or is there still a lot more runway on that front?

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

Well, there's certainly runway in our newer markets. We have a very clear kind of position. It takes a little bit longer in Florida and the Mid-Atlantic and certain pockets of the country to get the stores up and running and moving the way we want to do it. I've been very encouraged by Florida, though, in terms of where we've been-- because those stores are now big. We're now getting some critical mass in areas like Tampa, and we're seeing some encouraging 2-year numbers out of our Florida business, which suggests kind of how we thought about this that it takes a little bit longer and you need critical mass from a marketing point of view. We've got a bit of work to do to build on that in the Mid-Atlantic market. But we've got -- we've got that -- the plans in terms of the stores that we talked about are very much about consolidating the store base around tighter

markets so that we can get the effective marketing in place. It takes a bit longer where we're not known and it goes a bit faster in places where we are known. And we're flexing our marketing communication a little bit on that as well as we go forward.

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

Great. And then you said you remain on track to reach your 30-store target for this year. I know it's still a little bit early, but any update on how you're thinking about unit growth next year? Would you still expect to return to your algorithm or some of the headwinds that have been impacted --

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

Sorry, yes, Mark. Yes, we're comfortable on the 30 number and maybe a couple more than that this year. But in 2024, we'll be on track for 10. We've got the sites approved on that as well, Mark. So we've got a lot of confidence in that.

Operator

And our next question comes from the line of Karen Short from Credit Suisse.

Karen Fiona Short - *Crédit Suisse AG, Research Division - Research Analyst*

I echo my congratulations, Chip, for retirement. So I did want to just ask 2 things. Looking at the second half sales growth versus EBIT growth, compared to what you just did in 2Q, there's significant divergence, I guess, in those numbers. So I know there's a lot of moving parts, but wondering if you could just parse out what those 2 -- what the components would be for that delta. And then -- so specifically, puts and takes on gross margin and SG&A? And then what specific inflation number are you thinking about for the second half?

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

Karen, this is Chip. First, thanks for the congratulations. I appreciate it. As it relates to the second half, really nothing's changed since our guidance at the end of the year. And even last quarter, I think we gave enough details to suggest that in the back half we wouldn't see the same kind of profitability gains predominantly because, number one, I think our margins are going to be -- our gross margins are generally going to be flat in the back half of the year. And on the SG&A front, we're going to have some deleverage specifically in the third quarter. And that -- the pieces of that are a couple. One, there's a little bit of timing in the third quarter that we talked about last quarter. The second is, as we get through the -- as we start to accelerate the store growth, that will put a strain on the P&L. And thirdly, as labor costs have been going up for everyone for a long time, as we said on the call, we take the labor cost and the store growth piece. We've really done a great -- our teams have done a great job of mitigating that transition through that. But at the moment, as we get -- we start to lap some things we did last year, it gets a little bit more difficult to mitigate those cost increases. That said, the good news is, at least on the labor front, the labor rates are beginning to stabilize. So it won't be as difficult next year. But for the back half of the year, it's a little bit of a strain. And as we accelerate the store growth, you know that's how that math works. But again, next year, middle of next year, we'll start to be in a stable place where the same number of stores are going in the ground every year.

Karen Fiona Short - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And inflation?

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

Inflation. So on the inflation front, our thought in the beginning of the year was going to be double digits in the beginning of the year from a year-over-year perspective. And then sequentially, as you migrated through the year, that you'd be in, call it, by the third, fourth quarter in mid-single digits year-over-year, and that seems to be starting to play out.

Operator

And our next question comes from the line of Krisztina Katai from Deutsche Bank.

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

I want to add my congratulations to Chip on the retirement as well. I have a follow-up question on gross margin, which obviously was quite strong in the second quarter, and I think that's despite some rising promotions throughout the period. So maybe can you talk about the drivers behind the gross margin? I know you mentioned better promotional leverage. But what are some of the other offsets that you're finding to really drive that performance there? For example, some of the Sprouts funded promotions seem to us like last week's sale in the private label items. And then within that as well, just my question on this, how you view your current price gaps and just how willing is drought to retain traffic and market share in exchange for managing margins at these levels?

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

Thanks, Krisztina. I'll talk about the margin and then Jack will talk about the gap. So from a margin perspective, we did come into the quarter, we were expecting some margin accretion. We did overperform on that line. It is partially driven by mix, both within the categories and then overall for the company, category to category as we see some of our higher-margin businesses are growing faster than some of our lower. And then within the categories, some of the items or subcategories, if you will, and the organics are growing faster than more commoditized. So that's helping. Also, as we talk about promo effectiveness, we're continuing to see ourselves more on the ELP and less on the promotional front. And then thirdly, a little bit, we've probably overperformed a little bit on just like probably 5 or 6 quarters ago as we saw costs rising, we got behind it a little bit. We got teeny bit ahead this time. That's sort of a transitory. So I wouldn't count on that going forward. And as we look for the rest of the year, we're really getting to that place where we think the margins are going to become more and more stable year-over-year.

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

So yes, Krisztina, the margin is in good shape, and we're comfortable the way it's being managed, and price gaps play a key role, particularly in our produce business, where we spend a lot of time looking at where we are. We're very aggressive on organic produce, and we've talked a little bit about how successful that's been for us. The whole context of our produce price gaps is in a good shape, and we're comfortable with where we're on that and we continue to look at it and continue to be where we've always been there. The other things that we look out on pricing, I'm very pleased the way the bulk pricing, given that not a lot of other people sell bulk foods, the fact that we are able to sell loose bulk on commodity items for customers where they can control the volume that they're purchasing and portion control. We're operating about 20% cheaper than our packaged goods on the equivalent items. So that's been an important part of our pricing mechanism going forward. And on our base business, our grocery business, our dairy business, our frozen business, still such a different assortment that we look a lot at elasticity on pricing as opposed to gaps and spend a lot of time working out what the right price is to maximize the volume. So it's very much in line with how we've been working our pricing all the way through. And as Chip said, we made some progress on the margin, and we continue to watch our price gap.

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

And just as a follow-up on e-commerce, which was strong yet again, I think you said it grew 16% in the quarter. Can you talk about the -- what impact the expanded partnership had with DoorDash on your same-store sales? And then just generally, how are you thinking about the sustainability of that e-comm momentum once you really start to lap the DoorDash expansion?

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

Well, as I say, we're very focused on being an omnichannel retailer that the customer will take us where they want to take us with regard to -- we want customers who are focused on our assortment base and our differentiated, curated assortment. And they seem to be navigating. The thing that's encouraging, Krisztina, for us is that we're seeing traffic growth in both e-com and in our bricks-and-mortar business, and it's kind of equal between the 2 of them. DoorDash has enhanced our growth a little bit in traffic a little bit in terms of working that through, and we're pleased with the partnership with both Instacart and DoorDash. Again, it's allowing the customer to choose how they want to engage with us. And as the DoorDash business is a little bit more immediate, people are looking for faster delivery relative to the Instacart business. But both of them are performing well for us, and we're encouraged by the progress that we're making on both of them.

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

And I would add in, the DoorDash is helping, but it's still less than 1% of the contribution of the comp.

Operator

And our next question comes from the line of Michael Montani from Evercore ISI.

Michael David Montani - Evercore ISI Institutional Equities, Research Division - MD

Also extend congratulations to Chip as well. I wanted to ask, first off, if I could, if you could provide some additional color on what drove the comp this quarter? Was it more transaction size or transaction counts? And then also intra-quarter trends and geographic trends, if there's anything additional you could share on the color front there?

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

This is Chip. Thanks again. So as it relates to the quarter, it was a really -- from period to period, it was a pretty stable quarter. So we had positive comp transactions throughout the quarter, every single period, slightly up. And again, we saw AUR benefit from inflation, and we saw a little bit of unit decline similar to what we've seen. As you got late in the quarter, you started to see that tapering up both the AUR and the unit decline. So that's kind of the mix of the transactions, but a mix of the comp. As it relates to geography-wise, again, we see -- it's been pretty stable across the geographies. I will say that some of our -- we're getting comps like Florida and the Mid-Atlantic where we have a mix of higher mix of newer stores, you get a little bit extra there from a comp. But generally, we feel really good. Those markets, those onesie-tuosie markets have been a little bit of a challenge for us. Those places where we have just a variable density, and they're pretty far away. Examples of that, we have one store in Louisiana. We have a couple in Oklahoma. We have -- they're just sort of onesies, twosies. Those are just not performing as well because we just don't have as enough brand density. So that plays out as to the story of why we want to densify our markets.

Michael David Montani - Evercore ISI Institutional Equities, Research Division - MD

Got you. And then if I could just follow up on the SG&A front. I wanted to see basically what you would need to see in terms of a leverage point from the comps in order to get natural leverage given the accelerated store growth and the wage inflation you're seeing? And then has there been

any deceleration, I guess, to start the quarter? Or was the low single-digit guide potentially looking at what could come, but you haven't seen it yet?

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

Well, I'll address the first part. So when we're growing -- when we're at this place where we're going to be growing 10% a year, you really do need -- if your gross margins are stable to keep your operating margin generally flat. So that leverage point, you need a 3% comp to be able to do that over the long haul, annual to annual. Any given quarter, you could have some puts and takes. We have a little bit of a, I'll call it, a take in the third quarter, which you've talked about. But outside of that, you need about a 3% comp to be able to do that. And what was the second question again?

Michael David Montani - *Evercore ISI Institutional Equities, Research Division - MD*

I just wanted to see kind of low single-digit guide, right? So the midpoint, call it 1.5% --

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

Oh, the low single-digit guide.

Michael David Montani - *Evercore ISI Institutional Equities, Research Division - MD*

Yes, yes.

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

Yes, we're a little earlier in the quarter than we were last quarter. So we feel -- I mean, we feel solid about the quarter. We feel good about the guide. But there's as it relates to what's in front of us, just -- it's no different than what we said last call, we said we were going to be essentially a 3% comp for the year. We were tracking to a pump or we said 2% to 3% for the year. We were tracking to a 3%. So that implied a 1% to 3% for the back half and here we are in the back half, and we're just -- we're tracking on for that. So that's where we think we'll be.

Operator

Our next question comes from the line of Rupesh Parikh from Oppenheimer.

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

Chip, congrats on your pending retirement. So I just want to go back to the traffic. So now traffic has been positive year-to-date. So just curious, as you look at your initiatives in stores, what do you think has been key in driving that positive traffic that you continue to see?

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

Yes. I think, Rupesh, what we've been trying to do is increase the customer engagement, both in-store and out of store. So the in-store space of it, what we've been doing is -- COVID got in the way of being engaging with customers, being able to talk to customers and guide customers and a lot of our customers come in to our store, and they're looking for advice, whether it be in the vitamins and supplements department, whether it be on certain dietary things. So we're trying to engage much more the teams being able to engage sampling programs being wound up pretty substantially. And I think the fact that we've got so many new innovative items, we've got this innovation table in our stores, which features 30 to

40 items every quarter that are completely unique to Sprouts. And we're doing a lot of sampling on that and seeing a lot of success in the drinks category, in the snacks category, in those type of initiatives. So sampling has been about engaging with the customer in the store and making sure that we're providing a faster, cleaner checkout service as well. So we're very pleased by the customer service scores that we get, which we measure significantly. We're now bonus the store, but as part of the bonus program. There's a customer service measure that we get. And the numbers that are very encouraging and ahead of where we expected them to be. So there's a lot going on inside the store, outside the store, we're finding ways to make it easier for people to navigate through the e-commerce experience with us, whether it be when we put pictures on the website, people can immediately access directly into the product and able to purchase the product. We've made a lot of progress. We've got a lot more to go, but we've made some progress on our app. We made some progress on our website. So this is this whole principle and it comes under the umbrella of customer engagement and the operating team have been doing a lot of work to try and make the experience when you come into a Sprouts store, superior to the experience you would get in other grocery stores.

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

Great. And then maybe just one follow-up question. So just on the consumer, are you guys seeing any shifts in consumer behavior whether trade down or anything different versus what you saw last quarter?

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

I think that trend continues a little bit. There's a little bit of trade down across the marketplace, and there's a little bit of trade down in our business. People buying slightly cheaper cuts of things. People buying slightly less items as they go through the store. So yes, there's a little bit of trade down. But as we've said often, our customer base who are in our stores to buy our unique assortment, whether it be dietary based or keto or paleo or vegan or plant-based, they tend to stick to though that's what their diet is and that's what they buy. They might trade around a little bit. So the behavior hasn't changed dramatically Q2 to Q1, and we're not seeing a lot of changes in that dynamic.

Operator

And our next question comes from the line of Kelly Bania from BMO Capital Markets.

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

Congrats as well for you, Chip, on your retirement. I was hoping we could go back a little bit to the gross margin. I think, Chip, if I heard you correctly, you said you're expecting flat in the second half. I think that means flat on a year-over-year basis to the second half. Maybe correct me if I'm wrong there. But can you talk about the factors that are supporting that? And I guess just given other grocers and obviously, a lot of other retailers talking about shrink, maybe you can just update us on where you are on the various buckets of shrink and especially as you mentioned you were, I think, rolling out some more self-checkout.

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

Yes, Kelly. So as it relates to margin, I did mean flat from a year-over-year perspective. So we're expecting to be pretty darn stable both in Q3 and Q4 from a year-over-year perspective. And as it relates to shrink, Jack was going to address it.

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

Yes. I think the dynamic in retail, there's a lot of challenges across the retail industry on the amount of theft that's going on organized crime behind it. We are not seeing that dynamic to the same extent as you're hearing from the other retailers, principally because a lot of the products that we sell are so niche and so differentiated. They're not quite as easy to sell on when people take things from us. We do have a couple of stores that

we're watching on vitamins and supplements and things like that. So we're definitely not seeing the dynamic that you're hearing about from other people. We continue to work hard at making sure strength in our pilots, which is all about fresh foods and how much are we putting the right amount to the store and as we can make some progress on that. And we're feeling that we've got a lot of progress to make there. But we've made some progress as well as we work on our systems and our replenishment to make sure we're out in the stores with the right time. We've talked often in these calls about PICAQ, perpetual inventory computer-assisted offering. That program is rolling out now across the chain, and we're making some progress on trying to get the right amount of product into the store at the right time. And these new distribution centers are helping us do that as well. But a work to do on systems, but strength, I think we've got strength under control, and it's a different dynamic to other retailers. Kelly?

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

That's helpful. And I think you talked about a favorable product mix shift, but I haven't -- I don't think I heard just about vitamins and supplements, in particular. How is that category doing? And -- any color you can share on just the trends in that category?

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

Yes. Well, we've been encouraged to that. There's a lot of post-COVID upside in people buying products for immunity, and we're certainly seeing that. Cold and flu season clearly makes a difference one way or the other and how that works from one quarter to the next. But underlying it, we're very pleased with the teams that are working in our vitamins and supplements department, who are providing a lot of guidance and advice to our customers when they come in and underlying for us, we're encouraged by it. Yes. It would have over-indexed related to the company comp.

Operator

And our next question comes from the line of Robbie Ohmes from Bank of America.

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

Chip, congrats on the retirement. My question is just when I -- when we listen to the thoughts on gross margin and labor and then the new stores hitting the P&L, can you give us any sort of ways to think about whether you can keep the gross margin and the EBIT margin in similar ranges for 2024 versus what you've achieved in 2023?

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

Yes, Robbie. First, thank you for the congrats. As we think about -- it's still early to think about next year. Obviously, we have a multiyear plan. We try to work from and just beginning to think about next year. But our goal is to keep the gross margins flat. And we'll continue to work to have our operating margins close to being flat, which means on the SG&A front, we're going to constantly have to do work. There may be quarters just like this year, I mentioned, there's -- the third quarter is a little bit dilutive on the SG&A line. But I do think the teams are rallied around those opportunities to find ways to leverage or at least to ensure that we're not de-levering on the SG&A line. So there's still opportunities to go after. It's just -- it gets a little harder over time, but I think the teams are ready to go do that.

Operator

And our next question comes from the line of Chuck Cerankosky from North Research.

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

Can you guys -- either one of you comment on the inflation you're seeing in the cost of private label merchandise? And then could you please give me your outlook on where you think that growth rate is headed as the economy normalizes. It's been obviously very strong growth and do your customers stay with it and keep buying or do they migrate back to branded product?

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

Well, let me start, Chuck, with the second part of your context, which was where are we in terms of -- our Sprouts brand product is not operating in the way that our private brand would operate across the traditional grocery space. We're trying to make sure that everything we're putting in behind that is differentiated and has a very -- it doesn't have a commodity space to it. So we believe the growth in our Sprouts brand, which is over 20% now will continue as the team that's at food and put in place in that space continue to find differentiated products that fit our target customers, and we've made a ton of progress on that. I'm very encouraged not just for the health enthusiast but this innovation seeker that we have. We're doing a really nice job of bringing products to the market that you can't find anywhere else under the Sprouts brand. So I'm encouraged for that, and I think it will continue to grow almost irrespective of how the economy grows. I think as a mix, as a mix of our business, our Sprouts brand will be strong going forward. In terms of cost base, again, for the same reason, we're having -- the impact on the cost side of Sprouts brand is very much about how the commodities are playing through, and there has been some volatility in commodity prices. How that plays into our Sprouts brand? I think it's difficult to say exactly. I think Chip talked earlier about what's going to happen with the -- rain sign, and how does that knock on effect have in terms of cost prices for raw materials going into processed products across the country. I think that's a little bit uncertain. But we are pretty confident we can -- we'll certainly be able to manage the product side of this and the team are very focused on making sure that we're buying these products at the most effective price we can.

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

Chip, good luck to you.

Operator

And our next question comes from the line of Edward Kelly from Wells Fargo.

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

Congrats again, Chip. I want to ask about inflation, a follow-up one on Karen's question. I thought I heard you say that you expect inflation to be in the mid-single digits in the back half of the year. I just wanted to clarify that. And if so, can you talk about the drivers of that level?

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

Yes. So the drivers of that would just be the prices that are already in place today. And as they play out year-over-year, that's how it's going to play out.

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

Okay. And then a follow-up is related to your promotional strategy. And this is a dynamic of promotional intensity versus engagement. We've heard some talk in the marketplace about increased promotional engagement through things like e-mail, for instance, with customers that may be attached to certain stores that makes it look like intensity is growing, but I don't know it might just be engagements growing, and I don't know how dialed in you want as to a level.

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

We can --

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

Yes, just kind of curious that how your strategy is evolving? Because obviously, your margin does not suggest intensity is picking up. So clearly, it seems like it might be engagement.

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

We are getting better engagement certainly. We're getting better at sending the right e-mails to the right people so that we're not diluting the effect of -- we'll get much better at as we get more data from our customers and then become increasingly personalized. The nature of our -- the nature of our proposition to the customer does rely on us being very personalized in the offer. People who have got particular dietary needs. Let's communicate in some term, we don't want to be communicating meat offers to the vegan customer and that we've got-- and we've got a lot of them. So getting more precise in how we do it is probably what you're seeing in the kind of dialogue about the promotion intensity. We as a business have no intention of investing a ton of margin being promotions, but we've got a lot of intention of making sure our promotions are more targeted, more accurate and more precise in terms of driving business for us.

Operator

And our final question for today comes from the line of Scott Mushkin from R5 Capital.

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

Chip, I think we're all going to miss you. So -- but not yet because you're going to be around for a little bit longer.

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

I will.

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

So my first question is more housekeeping. I know you guys said you were going to close. I think you said 11 stores this year. It looks like a bunch of those were in the second quarter. How do we -- how should we look at net new openings as we move forward? And what's your expectation for net openings this year? And how do we think about next?

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

Well, if you think about it, we will have close to 11 this year, and we will open at least 30. So just doing the math there, that's 30 -- I'm a finance guys. So I can get that that's a net of 19 plus -- I had some question answer. So a net 19-ish or a little bit more this year. And then as we think of next year, next year, we're targeting 10% unit growth, there shouldn't be any closures like we did this year. Is there 1 or 2 off that we might end up as the leases expire, there might be. But generally, we should be looking at 10% net growth from 2024 and beyond.

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

Okay. That's it. So then my next question, and I think it's kind of been touched on a little bit, but I just wanted to get out of maybe a little more is around kind of the glide path in earnings as we progress forward. Thinking about the comp, I think it's going to come in this year is in the middle of your range of 2.5%. Without a big acceleration next year, it just seems like the earnings growth could be more muted? Or am I thinking about things wrong?

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

Well, I think if we -- if you think about it that we're trying to drive towards a 3-ish plus comp, and we're trying to keep our gross margins flat and our SG&A then would grow in line with top line, which would be, call it, high singles on top line. So to 10-ish. That gives you an operating margin that's flat and you get earnings growth in the high singles pre-share buyback.

Can we do that? I think we have a lot of confidence probably more than some of your peers that we can really keep our gross margin stable. We have a ton of confidence there with our differentiated product, how we go to market, differentiated customer base, we feel like we can keep that. As it relates to the cost basis, yes, right now, we are accelerating store growth. So we have to manage through that. The good news, the other thing that's been hitting us has been labor cost. Labor cost growth is beginning to decelerate. So I think going into next year, we'll be in a better place that we can manage that. And I think, as I said earlier, and I know it sounds oversimplified, but we have an aligned team here and aligned building and align store set that knows that we really want to manage our costs and keep them under control. So we're always looking for opportunities. And there's we'll be able to -- I have confidence we'll be able to do that. We've made a lot of investments in our store support office over the last couple of years, and we're getting to a place where that does not need to grow nearly like it has. We had to put in new systems, we had to add more people. We had to invest across the board. We invested in merch planning, we invested in financial planning. We've been all over the board. We're getting to a place where we can begin to leverage the corporate part of it, it's just about managing labor at that point in the stores.

Operator

Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Jack Sinclair for any further remarks.

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

Thanks very much, everyone, for all the questions and your attention. And thanks again to Chip, and congratulations on his retirement. But as Scott just said, he's got a bit more work to do because he's not going until the end of the year. And we look forward to working through the next few months together. Thanks again for your attention. Take care.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.

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