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SFM.OQ - Q1 2024 Sprouts Farmers Market Inc Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the First Quarter 2024 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker Susannah Livingston, Vice President of Investor Relations and Treasurer. Please begin.

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

Thank you, and good afternoon, everyone. We are pleased you are joining Sprouts on our first quarter 2024 earnings call. Jack Sinclair, Chief Executive Officer; and Curtis Valentine, Chief Financial Officer are with me today. The earnings release announcing our first quarter 2024 results, the webcast of this call and financial slides can be accessed through the Investor Relations section of our website at investors.sprouts.com.

During this call, management may make certain forward-looking statements, including statements regarding our expectations for 2024 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 want to start by thanking our 32,000 hard working team members who work together to create a great experience for our customers, which in turn delivered impressive financial results.

Our sales have grown by 9% with comparable store sales growing by 4% and diluted earnings per share growing by 14% compared to adjusted diluted earnings per share in the same period last year. These positive results reflect the effectiveness of our strategy and the exceptional execution by our team. It has been a strong start to the year. And we're encouraged by the continued momentum in our business.

Our entire approach across the business remains centered around our target customer. We have aligned our merchandising, marketing, operations, new-store design and supply chain strategies to provide the freshest, most innovative, attribute-driven products in the marketplace. We have also created a unique and easy-to-shop format with great service.

During the first quarter, we organized Sprouts brand in organic events, which were highly successful. These events and others led to positive customer traffic growth in the first quarter. We are pleased to bring Sprouts to more communities across the country. The new store program continues to gather pace. We opened 7 for the quarter and are on track for the year. And we're committed to helping our customer live and eat better with every new store opening across the country.

I'll follow up with more on our journey in just a bit, but for now, I'll hand it over to Curtis to review our financial performance in the first quarter and our 2024 outlook. Curtis?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Thanks, Jack, and good afternoon, everyone. For the first quarter, total sales were $1.9 billion, up $150 million or 9% from the same period last year. This increase was driven by comparable store sales growth of 4% and the addition of new stores. We had another quarter of positive traffic, and as expected, average unit retails and units per basket continued to stabilize sequentially. Our business continues to be resilient. Our comp performance highlights the categories with the most differentiation, such as grocery, dairy, frozen and meat continue to attract our target customers and drive our results.

Sprouts Brand growth continued to outpace total company performance and contributed 21% of our total sales for the quarter. Our e-commerce sales grew approximately 25%, representing 14% of our total sales for the quarter. This included incremental sales from our recently launched Uber Eats partnership and all 3 of our online partners joined us in promoting healthy trends to create momentum in the new year.

The fact so many of our target customers seek out Sprouts online continues to highlight the appeal of our differentiated assortment. Our first quarter gross margin was 38.3%, an increase of approximately 80 basis points from the same period of the prior year. This improvement was primarily due to a significant turnaround in our fresh shrink performance, driven by our continued focus on inventory management. We also continue to see year-over-year margin improvement due to promotional optimization efforts carrying over from 2023.

SG&A for the quarter totaled $540 million, an increase of $57 million or approximately 80 basis points of deleverage compared to adjusted SG&A from the same period of the prior year. As anticipated, the first quarter was impacted by approximately $4 million in holiday pay with the New Year's Day falling in the first day of fiscal 2024. Our strong sales performance led to higher e-commerce fees as well as higher incentive compensation for the team.

Last quarter, we shared our plan to invest $15 million in 2024 to build a foundation for sustainable long-term earnings growth and we are on track with approximately $2 million spent in the first quarter. Store closure and other costs totaled approximately $2 million for the quarter. These are primarily related to the ongoing occupancy costs from our 2023 store closures. Depreciation and amortization, excluding depreciation included in the cost of sales was $32 million.

For the quarter, our earnings before interest and taxes were $148 million. Interest expense was approximately $1 million and our effective tax rate was 23%. Net income was $114 million and diluted earnings per share were $1.12, an increase of 14% compared to adjusted diluted earnings per share from the same period of the prior year.

During the first quarter, we opened 7 new stores, ending the quarter with 414 stores across 23 states. A strong and healthy balance sheet has underpinned our financial performance. We generated $220 million in operating cash flow, allowing us to self-fund our investments of $46 million in capital expenditures, net of landlord reimbursement to grow the business. We also returned $60 million to our shareholders by repurchasing nearly 1 million shares. We have $148 million remaining under our current share repurchase authorization. We ended the quarter with $312 million in cash and cash equivalents, $125 million outstanding on our $700 million revolver, and $21 million of our outstanding letters of credit.

Turning to our outlook. For the full year, we expect total sales growth to be between 7% to 8% and comp sales in the range of 2.5% to 3.5%. We plan to open approximately 35 new stores, all in our current prototype. Adjusted earnings before interest and taxes are expected to be between $415 million and $425 million and adjusted earnings per share are expected to be between $3.05 and $3.13, assuming no additional share repurchases.

That said, we do expect to continue to repurchase shares opportunistically. We also expect our corporate tax rate to be approximately 25%. During the year, we expect capital expenditures net of landlord reimbursements to be between $225 million and $245 million. To add a bit more color to the full year, we expect gross margins to be up as we continue to focus on initiatives to improve shrink and annualize our promotional optimization work from 2023.

On the cost front, we expect ongoing wage increases, new store deleverage, and our strategic investments to pressure SG&A, resulting in an additional deleverage in 2024. For the second quarter of the year, we expect comp sales in the range of 3% to 4% and adjusted earnings per share between $0.75 and $0.79. We are expecting more moderate year-over-year impacts in both gross margins and SG&A as we lap fewer outliers in our second quarter comparison, resulting in gross margins up slightly, while SG&A will deleverage slightly.

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

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

Thanks, Curtis. We remain committed to serving our customers, our health enthusiasts with products that help them live and eat better. Our team is dedicated to finding innovative and distinctive products with attributes such as organic, gluten-free, grass-fed or vegan that set us apart from others. The success of our foraging program has continued as sales on our innovation center continue to grow, and we believe we have become the destination for exciting entrepreneurial food companies to introduce their unique products to the marketplace.

This innovative spirit lives within our Sprouts brand and culinary teams as they continue to add hundreds of new items like hot honey chicken tenders, non-dairy frozen desserts, and flavored cauliflower rice. Additionally, as I mentioned earlier, in-store experience and customer engagement remain paramount for us. Part of our appeal is our friendly and knowledgeable team members who help customers navigate the differentiated assortment available to them.

The team's dedication to our customers in the first quarter resulted in some of the highest customer service scores in our history, a remarkable achievement. Sprouts is incredibly fortunate to have the support of many customers who truly love our brand. As a complementary shop, we have an opportunity to deepen our engagement with our customers and grow their share of wallet through a loyalty program.

Our vision is to distinguish our program by enhancing what our brand already does, helping our customers in their passion to live and eat better. This is a multi-year endeavor that will enable Sprouts to build a thriving community where our customers can engage with our brand and we can provide them with personalized content catering to their unique shopping preferences.

Our upcoming beta launch of Sprouts Rewards in 2 markets this quarter is just the beginning. And we're excited to continuously improve the program by incorporating feedback from our customers and team members to enhance the experience, functionality and technology overtime. One of the reasons our customers and team members love Sprouts is because our values are aligned. We all care deeply for our communities on the planet. We recently published our 2023 impact report highlighting our work in areas we believe matter most to our target customers, areas such as responsible sourcing of sustainable products, waste reduction and supporting the communities we serve.

In 2023, $3.3 billion of our sales were from products with social or environmental attributes. Our transition to reusable bags removed approximately 130 million single-use bags from circulation, and our store donated 29 million meals to those in need within our communities. It was exciting to see our team members support our Healthy Communities Foundation by donating over 5,500 service hours to build school gardens that help kids grow healthy through nutrition education. I encourage you to read through the report to get a flavor of our focus areas and impact.

I was delighted with the opening of several new stores during the fourth quarter from Cudahy, California, to Burtonsville, Maryland. In the first quarter, we launched 7 new stores and are on track to open approximately 35 by the end of the year. We have an extensive pipeline of approximately 100 approved new stores and 70 executed leases, a testament to our commitment to expanding our brand and access to healthy foods in more communities across the country.

We've also seen improved new-store openings this year and we attribute much of this success to better brand awareness as we continue to densify markets and we have growing confidence in our real estate site selection model, which continues to evolve. These improved openings coupled with continued comp momentum in newer markets and our robust pipeline will support our growth aspirations.

Internally, our team is making great progress in building a best-in-class workplace through our values and culture. Our retention rates are currently at an all-time high, which is a tribute to the intentionality behind this work. We're seeing improvement across the board in our team member engagement scores and believe this focus on culture is translating into the great customer service scores that we're seeing. We know that our journey towards improving our culture is ongoing and we are excited for the progress we've made thus far.

In addition to the culture work, we're focused on preparing our leaders for growth. We aim to have a pool of skilled team members ready for future assignments. We typically promote close to 60% of store managers from with them. To prepare them for leadership roles, we have developed assistant store manager leadership tracks, over 30 graduated this year from our initial cohort and another 50 team members entered the program in 2024.

In closing, the continued momentum we are seeing is a demonstration of the effectiveness of our execution. We're delighted to receive encouraging feedback from our customers, which confirms that our collective efforts are making a meaningful impact. Our store, distribution center and support office teams are ambitious for Sprout's future and are determined to deliver on the opportunities that lie ahead.

Moving forward, we remain focused on execution, both day-to-day in our stores and on our investments for the future, all while keeping customers our top priority. Thank you for your support, and we look forward to connecting with many of you in the coming months.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will be coming from Leah Jordan of Goldman Sachs.

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

Great job on the quarter. Just wanted to start off on the comp. What was the primary driver for the outperformance versus your expectations? How did traffic trend throughout the quarter? And what do you attribute to the recent market share gain?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Leah, thanks for the note there. So yes, comps outperformed, it's really coming from a lot of different things. I think it's a little bit of everything just being a little bit better than we expected. So continued positive, solid traffic, the AUR units stabilizing as expected and the business just continuing to hum along. So we're pleased with the performance in Q1.

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

Yes. We're seeing positive traffic in both e-comm and in our bricks-and-mortar business. We're seeing positive traffic in terms -- positive basket in both of those channels that we have. So we're kind of feeling positive about that. And basically, everything seems to be in good shape.

On the market share gain question you asked, Leah, just to comment on that a little bit. We kind of -- market share is difficult for us. We kind of look at our own business and see how well it's doing because it's very difficult to define what we do within the context of the total grocery market share. But certainly, in the last -- since the pandemic, I think, people have been more comfortable in shopping in more places, which suits us as a complementary shop.

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

Okay, great. That's very helpful. And then a follow-up, I just wanted to ask about gross margin. I mean, it came in really strong expansion in the quarter. You talked about some of the tailwinds earlier. Just how can we think about it for the balance of the year? How much of the magnitude from -- will moderate on the promote optimization side for the rest of the year? And then you said it would be up for the full year. Any more color compared to last quarter when you said it would be up 20 basis points to 25 basis points given the strength in the first quarter?

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

Yes, sure. I think, so for the year, I would say up approximately [$50 million] now. So certainly, we got better flow-through in the first quarter than we expected and it was really a shrink story. And we talked about it on the last call, but we had challenges throughout last year and particularly in the second half. And really credit to the teams, they got on top of it late last year. And that turnaround just happened a little faster than we expected and resulted in really good performance.

Really just a focus on inventory management and some of the things that we're investing in, and the teams really working together, be it operations, merchandising, some of our analytics teams and our IT team coming together to help the business figure things out and get things moving in the right direction. But yes, for the full year, I expected up about $50 million on the growth side.

Operator

And one moment for our next question. And our next question will be coming from Mark Carden of UBS.

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

Nice quarter. So to start, maybe a follow-up on that last gross margin question. Obviously, a lot is going right now, clearly benefited from shedding coupon clippers. 1Q is historically your strongest quarter from a seasonality perspective, the strong performance inventory management. Just thinking about 1Q relative to maybe 1Q next year, was this pretty much a perfect backdrop for you guys? Are you approaching upper bound or do you still see more room to go from here? So in other words, when you think about the benefit in the back half of the year, is that just these current tailwinds or do you see really more room to scale up?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Yes. I think we're pleased, there's a lot in that. So I'll try to tackle them piece by piece. But we feel good about our margins. Certainly, bottom line, we expect to be a stable business and the gains we're experiencing there in gross margin, there's nothing in there that was particularly one-time in nature. It was a soft compare year-over-year, which definitely helped from an overall magnitude perspective. It won't be quite that big going forward.

But again, we feel good about the work that we're doing and we feel like it's sustainable and that we're kind of changing the water level and shrink here moving forward, and it will be a little bit better here in 2024 than it was in 2023. And longer-term, we talk about it a fair amount. We're still a fairly immature business. So there are opportunities. There are pressure points as well. And net-net, we plan to manage the business to stable on the bottom line and continue to grow the business.

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

And, Mark, the gross margins particularly, there's kind of buckets that we look at, shrink certainly been a big benefit for us in this quarter. And I think there's continued opportunity. As Curtis said, the immaturity in our business as we get better at managing inventory with some of the systems that we put in and are applying increasingly more effectively. I think there's some further benefits on that going forward. We're getting a little bit better at promoting more effectively and understanding the elasticities. Well, that's been an ongoing thing over the last few years. And I think we're just gradually getting a little bit better of being efficient at promoting when we do promote.

And there's been some drivers on mix, which I think will continue to help us in terms of mix, mix towards organic and mix towards some of the more attribute-based products that we work increasingly getting a reputation for. I think those 3 buckets will help us going forward.

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

Great. That's helpful. And then as a follow up, we've heard about some pressure on restaurant demand recently. Do you think Sprouts has been experiencing much trade-in from outside of food at home? Have you seen any uptick in prepared food sales or do you think it's mainly just coming from within food at home?

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

No, I think we've got -- we have had some benefit from that. I've been very pleased by the investments we've made, that the team have made inside the stores. We've put a number of new cabinets in to support the meals space from both the meat business and the dairy business, and we've seen some good benefits on that. Our frozen business has been strong. So the kind of 3 big buckets that come basically from people eating at home as opposed to eating in restaurants, I do think we've had a bit of a benefit from that. And who knows how the economy is going to go over the next 6, 9, 12 months, but I think it's more likely to be a benefit than the disbenefit going forward.

Operator

And one moment for our next question. Our next question will come from Michael Montani of Evercore ISI.

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

I wanted to focus in on 2 areas, if I could. One was just on shrink. I think for you all, it's more a story of efficiency gains versus theft. But just wondering if you can give us some incremental color there, Jack, in terms of what you've seen and what the opportunity could be? And then secondly, on the wage and benefit front. So can you just provide an update about what you all are experiencing there and what you're looking for this year in that line item.

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

Sure, Mike. I'll let Curtis add a little bit more color, but on the 2 buckets, shrink, we've made some benefits, particularly in our fresh shrink. And as you correctly say, it's less likely -- we don't experience the kind of theft that you're hearing from a lot of the non-food retailers going-forward, partly because our attribute products are so differentiated. I think it's harder for people to steal them and sell them on, to be honest with you. So I think we're getting -- we're not seeing the kind of issue in that space that a lot of other people are doing, although we continue to watch it.

The real benefit lies in how we manage our fresh inventory. And we've got a bigger fresh mix than most. So the opportunity is bigger going forward as we get into these much more better replenishment systems. We've got an initiative around here called FARM, which is Forecasting Allocation Replenishment Management, which is allowing us to, I think, get better at putting the right amount of inventory in the stores at the right time. And we're immature in this, Mike. So that remains a continued opportunity going forward. And we're kind of -- I'm very pleased the way the teams and the operations teams have really made some progress on that with a lot of support from the merchants and the IT teams.

With regards to wages and benefits, one things we're very encouraged about is the retention rates that we're having in our stores. And we think that's having a positive benefit. You don't have to pay as much for training, you don't have to pay as much for enrollment. So the fact that we're operating at a very significant improvement on retention gives me a lot of confidence that the way the teams are managing each other is a positive and is working well, and as I alluded to in my remarks. I think some of the work that we've done on culture and values and purpose is beginning to pay dividends in actual improved retention.

Wages are going to continue to rise, and we've got that in the numbers going forward. And one of the reasons we think retention is working is we're doubling down on communicating the benefits that we give, whether it be health care benefits and bonuses. We pay bonuses some -- quite a number of stores, everybody in the store gets a bonus. The leadership team, well over 90% of the leadership team in every store got a bonus. And those numbers are significantly rising, and it's all self-financing. So we're very positive about the way our bonus programs have been working. So I don't know whether you want to add something to that, Curtis?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

No, I think the only color maybe on shrink is about -- we've talked about just about 75% of our shrink is in the fresh side. So just to add some context to that, that theft piece is pretty small for us, as Jack alluded to.

Operator

One moment for our next question. And our next question will be coming from John Heinbockel of Guggenheim Securities.

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

So Jack, let me start with what do you want to learn from the 2 test markets with the loyalty program? And then what do you think the benefit lies, right, traffic, basket? And I don't know if it's hard for you to figure out your wallet share. But how do you think about that?

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

Yes, John, great questions and they very much relate to -- first of all, the benefits will come in 2025. The work that we're doing in 2024 is, first of all, to get the plumbing right and the pipe work right so that we've got the proper marketing technology behind creating a very efficient experience for the customer so that it's a seamless and efficient experience. The 2 test markets that we're doing, we'll learn whether that works or not, and we'll get the -- we'll iron out the kinks in that. And then by the end of the year, we'll extend that to a pilot in a broader sense with more stores.

So through 2024, we will learn how to do this as when it comes to 2025. And that will be an iterative process as well. What do we expect to happen, as you alluded to, we're expecting an increase in share of wallet of our target customers. I think we'll be able to understand those customers so much better that we'll be able to increase it. And we've got a measure, some measure of what -- where we are in terms of share of wallet. And I think we've talked about that in the past. It's double-digit, but it's not into -- it's not hugely into the double-digits above the kind of low-teens.

And that context -- that's the context that we'll be expecting to drive a little bit more of share of wallet from those target customers. And that will more than fund this and pay for this thing going forward. So as I said, the benefits will come in 2025. The learnings will come in 2024. The first element of the learnings are about technology and marketing technology. The second element of the learning are about understanding our customer so that we can stimulate and create this feeling of being part of something special -- by being part of the Sprouts ecosystem. And we're pretty excited about it. The team are doing a lot of work behind the scenes, as you can imagine, and we're excited about what's going to come out the other end, John.

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

Maybe second thing, right, you're obviously adding a lot of stores this year and you did last year a little bit in the Northeast. So when you think about the timing, right, of that DC, how do you think about that now? And how far can you push the envelope? I know the idea was going well beyond or potentially well beyond produce in all of the DCs. How far can you push that?

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

Again, there are -- we've created the infrastructure that allows us to have choice in this and linking back to what I was saying about our FARM initiative, when we get our replenishment mode in place that I wanted to get in place, we'll have a lot of optionality. We want to get more control of our Sprouts brand business going-forward. We probably think there's some elements of our fresh business that we can take hold of. We've got capacity to do that.

As you alluded to, we've not quite got there in the Northeast yet, but we will be. There's a lot of work going on about what's the right distribution, where the right place for the distribution is and what the optionality is for us in that space. I'm hoping we'll be there by 2026 at the latest in terms of having that in place. So we've got -- we're creating the optionality by the working -- by the work we're doing now. And going into 2025, you'll definitely see us selling -- doing more than produce.

Operator

And one moment for our next question. And our next question will be coming from Rupesh Parikh of Oppenheimer & Co.

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

Also, congrats on a nice quarter. So just on the e-commerce front. So as you've added UberEats, DoorDash in recent years, just curious if you're seeing the incrementality at this point you would have expected with these additional partners.

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Yes. We are really pleased with all 3 partners. We've seen strong business out of all 3. They did a really nice job in the new year. The healthy fresh start to the year that everyone goes through. It's a big time for us, and they were great partners in that respect. And yes, it's been incremental as expected. So we've added both partners over the last 2 years and seen really strong results.

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

And the good thing about it, Rupesh, as you've got DoorDash and Uber Eats have both got a kind of different customer base. So I think we're bringing some access to the assortment that we have to a slightly broader base. So it's been working well, as Curtis said.

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

They play a little differently geography wise too. So again, it's allowing us to access new and different customers. And it's an increasingly omnichannel world, and then that helps us as well from a convenience standpoint for those customers that are a little further away from our stores.

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

Great. And then maybe just one follow-up question, just given all the concerns out there in the macro, clearly your business is performing quite well. But just curious what you're seeing from the consumer, any new trends to note or just anything -- any changes what you're seeing with your consumer?

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

Well, one of the things we've always talked about is that we feel pretty confident that the assortment that we have, if you're a vegan, you're going to stay a vegan irrespective of what's going to happen in the macro world. So we feel there's some moat, if you like, to the macroeconomic environment. I think there is a lot of uncertainty. And we continue to watch it very closely. We believe that what we are doing and targeting those specific health enthusiast customers, there's a few more of them. Again, whatever happens in the macro-environment, and we feel that that's going to stand us in good stead going forward over the next couple of years as that customer base continues to grow, and we continue to work hard at serving that customer base appropriately.

So again, I don't want to dismiss the macro-environment, but it's something that we think we're a little bit shielded from them, almost from them whatever happens here. And to be honest, Rupesh, your guess is as good as me, what's going to happen in the macro-environment.

Operator

And one moment for our next question. Our next question will come from Scott Mushkin of R5 Capital. R5 Capital.

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

So kind of a 2 part question here. So I mean, obviously, margins have been trending up and you talked about it being stable. But just from like a company philosophy perspective versus margin rate versus margin dollars, where do you kind of think the rate is kind of where you want it to be and you're going to focus more on the dollars and even accelerating sales more?

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

Yes. Scott, let me have a start at that and then I'll pass it on to Curtis to talk specifically on the margins. Our primary focus is traffic and top line. And everything we're doing is making sure that we're serving our target customers better and better. And we will be able to manage our margin within that context, but we'll be sensitive to it in terms of how that works going forward. Having said that, I think the elements of what we've talked about in terms of shrink, in terms of the mix of the product and a better thinking around our promotion, our evolving thinking on our promotion gives us opportunities going forward.

But at no stage will we compromise margin or customer top line, if there's an interaction between it. So far, we haven't hit that point, and I'm feeling pretty confident about that we can manage both pretty effectively. But as I say, the important thing for us is traffic.

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

And, Scott, I'd just add to that. I mean, I think about it on the bottom line and EBIT margins being stable, and we feel really good about being able to do that in the short-term, long term, et cetera, to what Jack spoke about. And sometimes, that will mean a little bit of investment in SG&A, like an inventory management investment so that we can get a better shrink. So we're going to work the immaturity in our business. And sometimes that will fall in a gross benefit and sometimes that will be an SG&A benefit. But really, we're focused on that bottom line stability and maintaining that going forward and we feel pretty good about being able to do that.

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

So my follow-up question to that is, let's just say the strength in the business continues. Obviously, you guys have had a nice little string of quarters. And it seems like the customers coming your way, macro may not matter as much. So if this strength of the business continues, what areas would you invest in more over the next couple of years?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

I think it's the same places we're investing this year will be key components, right? So inventory management, we've talked about the technology underpinnings for scalability. We'll continue to work on that and make sure we have the right foundation to continue to grow. And then loyalty will be a multi-year journey that we'll continue to improve upon. And I think the last piece is team and talent is critical for us and we've got to continue to find store managers, department managers and great team members who engage with the customer, take care of our target customers and provide a great experience in the store. So those will be the places that we'll continue to double down and make sure that we've got the right foundation and we're scalable for the long haul.

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

And we need to invest -- going forward, supply chain is going to be important to us as well, Scott, in terms of making sure that we're giving ourselves the options of supplying maybe broader geographies than where we're at the moment. That's not for now. But as we go forward, there's plenty of places in the country that we don't have a Sprouts store. So we continue to accelerate that as we continue to see success and strength in our business.

Operator

And one moment for our next question. Our next question will be coming from Robbie Ohmes of Bank of America.

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

Jack, can you talk a little more about the new store performance in the first quarter? It was a pretty significant improvement in your new store productivity. And I know you mentioned a little bit. Any more color on where stores opened a lot, say, earlier in the quarter, like how is there such a dramatic improvement in new store productivity?

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

Well, it's only 7 stores, and we were pleased by how those 7 stores performed, most of them, 6 of the 7 stores, we're very pleased with. But I think partly it's what I alluded to in the remarks. I think we are seeing the success of our new store modeling just beginning to find the right place, a little bit more accurate in terms of where we open stores. And that's something that's encouraging. I think, again, when you look back when we opened stores during the pandemic, I think it was harder to drive traffic to those stores as people were reluctant to go to lots of places to buy their groceries. And we talked a lot about that probably over our conversations in the last couple of years.

So I think the benefit, we're getting a better store model. I think we're getting a little bit better at marketing. And I think putting the right -- putting concentrating stores so that we've got more stores in geographies, people are beginning -- awareness has always been a challenge for us in markets where we're not known and getting more of them and driving that awareness. I think Florida has helped us a little bit in that sense, the work we've been doing in Florida. We're up to a significant number of stores there and now we're filling in and that's I think benefiting us as well going forward as we build the store program.

And I think we'll see that benefit start to happen fairly significantly in the Mid-Atlantic going forward as we go into the next couple of years because we've got a lot of stores coming from -- in all sorts of places. And we think there's some real benefit by having that concentration in our store portfolio.

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

And any regional -- any more regional differences to call out? You mentioned Florida, but were any regions particularly stronger this quarter than others or types of markets new versus existing?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

No, I think the trends have been pretty consistent for us. We're not seeing any major departures from what we've seen the last several quarters. The new markets are performing well. We're excited for the momentum, but it's kind of come in similar to what we've seen in prior quarters.

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

And it has given us a lot of encouragement when we open in a place like Burtonsville, Maryland, where the team have done a terrific job. That is making us real confident. We kind of expect -- strangely, we expect to do well in California, but we're doing well outside of that as well. So that's very encouraging, and Florida, as we talked about.

Operator

One moment for our next question. Our next question will be coming from Kelly Bania of BMO Capital Market.

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

This is Kelly Bania. Just wanted to follow up on the e-commerce topic. Are DoorDash and Instacart still growing? I assume maybe some of the outsized growth here is coming from the newest partner at Uber. But just wondering if you could talk about that. And also, just the fee structures, are they similar for Sprouts and for consumers across the 3? Or is there any preference, I guess, from your vantage point between the different partners? And then also just to follow-up on competition with e-commerce, would you expect any competitive impact from Whole Foods given the new membership model that they recently-announced with Amazon?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

I'll cover kind of the first couple of those and maybe I'll let Jack cover the last one. But on ECA all 3 are really performing well for us. So we're really pleased with the results in all 3, and I won't get very specific, but definitely all 3 are growing and we're seeing strong overall e-comm performance. On the fee structure, again, I won't get into specifics there, but we're comfortable with the fees we have. We work closely with our partners. And for us, there's really no preference between the 3, wherever the customer wants us to be, we're happy to be there for them. And if they want to go through the stores, great. If they want to go through Instacart grade, DoorDash, Uber Eats. However they want to engage with us, we're happy to have them.

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

Just to reinforce what Curtis said, we're very pleased with all 3 partners. They do a great job for us and all 3 of them are performing well in the context of our e-comm growth. With regard to the Amazon Whole Foods conversation, Kelly, we watch Whole Foods -- Amazon have made a lot of statements about food and fresh and we kind of watch them with interest. We feel our positioning is pretty strong against Whole Foods, which is the context of this that I would look at. In terms of value on produce, particularly organic produce, we feel we're in a really strong place for the customer irrespective of whatever the delivery charges are.

We're in a good place, relative value on fresh produce, which is an important part of our mix, less important part of their mix, but an important part of our mix. So we look at that carefully, and we watch the pricing versus Whole Foods pretty carefully on everything else but produce. And we feel we're in a pretty good shape there. And we watch it carefully, but it's not something that's got -- we feel as if we're in a good place position versus Whole Foods on product and pricing irrespective of what's happening on the delivery charges.

And that's one of the reasons we think our e-comm business is so strong. The differentiation that we have, why would you buy all your groceries through e-comm to Sprouts unless there was a really strong differentiation? And I don't think it's easy to switch. So that's what gives us some confidence, but obviously, we'll watch it closely.

Operator

One moment for our next question. And our next question will be coming from Chuck Cerankosky of Northcoast Research. Again, our next question will come from Chuck Cerankosky of Northcoast Research.

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

Jack and Curtis, can you talk about inflation and the 4% comps, how much was in there? And how are your customers reacting to categories or SKUs that are inflating more than the average?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Yes. So from the kind of comp driver makeup solid positive traffic again this quarter and then continued stabilization in the AUR and unit story. So a little bit less inflation this quarter than last. And we're really to that place now where it has stabilized. We're low-single-digit inflation. We're still slightly negative on the unit side, but getting closer to flat with each passing kind of quarter and month. And it's all playing out as we had anticipated. And then from a customer perspective, we're not really seeing a material change in our trajectory and trends there. I think the similar things that we were talking about in prior quarters are continuing to play out, but no major reaction or change in customer behavior as it relates to inflation or price there.

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

Yes. And Chuck, the categories that you see the most volatility is the fresh produce areas. When you see avocados going up dramatically or coming down dramatically, we will double down and either sell a bit less or sell a bit more. And customers do react to price in the fresh produce space linked to the inflationary trends that are happening in that category. And it's very volatile, which is one of the reasons our inflation doesn't quite mirror what you see with everybody else. And but to Curtis' point, we're not seeing any specific categories that are going up so much that we're worried about the unit volume any more than we kind of always have been.

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

And you've made a lot of strides in private label and that's being helped by people looking for value with the inflation even as it slows down. How is that trading off with all the new products in your innovation centers?

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

Yes. Well, we're trying to be balanced on that. We're not in the world of private label where it's about trading down or commoditizing against brands. We're very clear about what our proposition is here. We're going to have innovative differentiated Sprouts Brand and the re-labeling and the new products that the team have done have been very encouraging. I think we've talked about 21% mix of our business, which is a really encouraging number in terms of where we used to be at 16%, but it's being driven by differentiation as is the branded businesses that are going into the innovation center.

We are trying to be the destination for new entrepreneurial products in our attribute health-based space. And if you look around our innovation centers, which are now in all our stores and continue to perform well, it's a very strong brand, kind of unknown brands that have got real kind of sense of differentiation and excitement for our customers and our team members. We want to be really good at Sprouts Brand on differentiated product and really good at branded items. And we'll keep away from those branded items that you can find in traditional supermarkets and traditional -- and the mainline Walmart's and people like that. We are going to try and be as different as we possibly can be. And I think that's standing us in good stead going forward.

Operator

And one moment for our next question. And our next question comes from Robert Dickerson of Jefferies.

Robert Frederick Dickerson - *Jefferies LLC, Research Division - MD & Senior Research Analyst*

This might sound like kind of a random question, but I'm going to ask it. I'm just curious, how is your frozen department doing? And I just ask because I follow all the groceries, but also follow companies that produce frozen products, let's say, frozen food in general has been kind of of relatively weaker over the past year or so on the volume side versus a lot of the other store. But again, you have differentiated product. So I'm curious, would you say, oh, our frozen department, we're seeing a little bit of that pressure or maybe you're not, which would clearly be a differentiating factor?

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

Yes, Robert, it's not too random a question. It's the kind of things we think about a lot, what's happening with different categories. So our frozen business, I think what happened during the pandemic is that frozen got a pretty big lift and there was a pretty big -- right across the marketplace. I think we have -- we doubled down in our stores on space. In our new stores, we're giving it more space than we used to give it because we believe the category that is frozen, it blends itself well to attribute-based products. It lends itself well to vegetarian-based products, plant-based products. And we've seen some success. I've been really pleased with some of the Sprouts Brand work that's really playing through well for us in the frozen cabinet.

So I don't know what's happening in the broader market. I think there was a boost through the pandemic and it might have slowed down a little bit in the broader market. But in our space, we are seeing some really strong comps. And I'm encouraged by what's happening in frozen. And I honestly don't know if that's in-line with what's happening in the rest of the market, Robert, but that's where we're at on it.

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Yes. And I think, Rob, I would just attribute that to it's a differentiation story. In our departments and categories where we have the most differentiation, those are the departments that have been drivers for us for comp, and frozen is among those. And team does a great job with the assortment, making it different as Jack alluded to, and that just fits well within that broader story of where we're different, we continue to do well.

Robert Frederick Dickerson - *Jefferies LLC, Research Division - MD & Senior Research Analyst*

Yes. Great. And then I guess maybe just a broader question. I know you continue to highlight your newer stores or some of the smaller stores, merchandiser stores with "more prioritized categories" that maybe have better growth potential. If you're going from, I don't know, 30,000 square feet, 25,000. I mean, these are like drastic changes on the box size. I mean they're smaller, better economics, everything that's great. I'm just curious, like, then where do you trim? Does produce get a little bit smaller, 35% of the store? I'm just trying to understand, I guess, more broadly kind of now if you open up a new store now, where would you view those better growth areas?

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

Yes. Well, the 23,000 square foot stores that we're building, that's what we're building going forward, the [35,000] we do this year and the numbers that we'll do next year, they will all be by and large 23,000 square feet. What did we do? We cut back fairly significantly the non-customer-facing space. So that the space that's required to create the behind the scenes in dairy, behind the scenes in bakery, behind the scenes in meat, we merged them all together. We created a lot more space in the back room than we've done. It took a lot more space out the back room.

So the consequences for the categories going forward is we ended up with a slightly less SKU assortment in our vitamins and supplements department, slightly less, but the rest of the categories, actually frozen got a few more SKUs as I just alluded to. And across the rest of the stores, it's pretty the same SKU count. Category-wise, we chased after -- we continue to focus on produce because that's one of the key drivers for our business. We put a little bit more space into frozen and grocery and dairy and probably a little bit less space around bulk and some of the other spaces in our stores. So by and large, we ended up with the same SKU counterpart from vitamins, a little bit more frozen, and a little bit more grocery. That would be kind of where we're at.

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

I think the key piece, Rob, is that when we crept up to 30,000 square feet prior to Jack's arrival, it wasn't -- again, it wasn't in assortment. It wasn't in the proposition, it was in fixtures, it was in kind of dead space and unproductive space. And so it was not hard for us to get back-down to '23 without impacting the assortments.

Robert Frederick Dickerson - *Jefferies LLC, Research Division - MD & Senior Research Analyst*

Okay, great. And then maybe just another quick one for me. It's just -- I'm just curious, as you enter a new market or expand a pre-existing market in area where there hasn't been a Sprouts, right, you opened the store. As you open that store, is this essentially kind of like word-of-mouth? I mean, I'm sure you have for signage and people drive by the store and they see it, but are there other ways to just try to kind of welcome the community, so to speak, to the actual store without having to spend a fair amount of capital to do so? That's all.

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

Yes, we certainly are. We make sure that where we open a store, there are enough people that look like our health enthusiasts in that catchment area. And that's what I was talking about in terms of aligning our model to the -- so the opportunity is there, the people are there, and our marketing teams are getting increasingly good at talking 4 to 6 weeks earlier than we open the store in terms of direct communication with those target customers. And we're working to get better and better at that. So there's a fairly intensive marketing approach on each individual store.

And it has to be different. It will be different when we open a store in Cudahy, Los Angeles, than it will be in Aberdeen, New Jersey. How we approach that and how we think about it will be different. But the teams are increasingly getting better at picking the right way to let people know. Certainly, we want visible sites so that when people drive-by, they can see it. We try not to hide them too much, but we try and get people excited in advance. And I spend some time talking to mayors of towns and trying to get them kind of excited about us coming into places that they don't know us. And so it's a combination of things that work, but our marketing teams are doing a great job.

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

And I'll just reinforce Jack's earlier comments around the density in the market helps. Certainly, when you open the 10th store in a market, it's easier than the first. And there is some word of mouth and just having the building up and the signage up as people drive by, the more and more stores you put in, the easier that gets. And all those things are coming together to help with new store performance.

Operator

Okay. And our next question will come from Krisztina Katai of Deutsche Bank.

Jessica Tamar Taylor - *Deutsche Bank AG, Research Division - Research Associate*

This is Jessica Taylor on for Krisztina. Just wanted to go back to private label a little bit. And in the past and today, you talked about like how you watch your competitors' interest but don't worry too much given the product and customer differentiation. So now the largest retailer has announced a new private label brand that's really aiming to increase its share from this set of customers who are more attribute driven and who are more health conscious. So how does this kind of change your view on like how you're watching that competitor and competitors in general who might follow that lead? And how does it kind of impact your go-to-market strategy for your private label and attribute-driven items.

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

Yes. Well, Jessica, good question. We've been kind of -- I've been reading with interest, the last couple of days, as sort of an initiative, we haven't kind of tasted it or eaten it all. I've forgotten whether it's called better for or something. What is it called?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Better goods. Better foods.

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

Better goods. So the way the way I've read it and we'll clearly watch it, Jessica, but the way I've read that, it's a tiering in your branded strategy. So it's trying to trade people up. It's not necessarily trying to trade people to attributes. And I think that's how I'm reading it. It doesn't feel like a health initiative. It feels like a trading up initiative on quality. And again, that's a pretty common thing from my background in the U.K., how people think about tiering. It feels more like a tiering exercise than it does a health and attribute-based exercise, although there will be some things in there that oat milk, this, and something like that.

But I didn't -- I felt it was more -- we love being next to Trader Joe's. I felt it was more a kind of let's look at Trader Joe's and take some business from that. But as I say, our Sprouts Brand business is very much focused on being differentiated, not about trading up people on the same thing. And so it's not going to change what we're going to do. We believe we've got a set of target customers that are very relevant to our business and that we can do 30 keto products. I don't think this Better For thing is going to be that kind of attribute-based initiative, but we'll clearly watch it and be sensitive to how that evolves and develops.

Walmart, I've got a habit of them, whatever they do is big.

Jessica Tamar Taylor - *Deutsche Bank AG, Research Division - Research Associate*

Yes, that's true. And just a follow up, can you talk a little bit about the cadence through the quarter for comp trends and any month-to-date or quarter-to-date trends?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Sure. I'll take that one. We won't get too specific here in the intra quarter, but pretty consistent from a comp perspective throughout Q1. Always Q1 is always a little bit noisy. There's usually some weather events and things like that, and you'll see some weeks up and some weeks down, but generally pretty consistent for us in the quarter. And then certainly within Q2 here, we're comfortable within our guidance range with where the business is trending at the moment.

Operator

And our last question will be coming from Edward Kelly of Wells Fargo.

Evan Ketterhagen - *Wells Fargo Securities, LLC, Research Division - Associate Equity Analyst*

Yes. This is Evan Ketterhagen on for Ed. I know we talked a lot about e-comm already, but just wanted to touch on it a bit more here. We assume that your online sales are included in the overall comp. But could you guys just confirm if that's correct and if that also includes your Uber Eats partnership that started up more recently? And then the 25% growth this quarter, a bit of an acceleration versus prior quarters. Do you think that the bad weather in January might have played a role there? Or should we just expect a higher rate of growth going forward with the increased number of partnerships that you have?

Curtis Valentine - *Sprouts Farmers Market, Inc. - CFO*

Yes. So first part of it, yes, it's embedded in our comp and included in our comp. And certainly, some of the acceleration would be the new partnership with Uber Eats, which launched kind of mid-to-late Q4 and has been ramping up. And then the last part is a good question. Yes, we definitely see that when there's kind of significant weather events, it tends to move some people into e-commerce and out of the stores. And so through the first kind of half of the quarter, we had a few of those and saw that phenomenon.

I would add too, again, all 3 partners recognizing kind of that health trend at the beginning of the year. That's our Super Bowl as Sprouts and they were right there with us and doing the best they could to capture that with our target customers. And so we had a lot of activity going on in those first 6 weeks of the quarter with us, with our partners to try to take advantage of that. And so I think all 3 of those things are contributing to that stronger e-commerce growth.

Operator

I would now like to hand the call back to Jack for closing remarks.

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

Yes. Thanks, everyone, for your attention and your support. And we look forward to catching up with you in due course. So thanks ever so much. Take care.

Operator

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