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PRESENTATION

Operator

Thank you for standing by well to Sprouts Farmers Market's second-quarter 2024 earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to turn the conference over to Susannah Livingston. Please go ahead.

Susannah Livingston - *Sprouts Farmers Market Inc - Investor Relations*

Thank you, and good afternoon, everyone. Here, please, you are joining Sprouts on our second-quarter 2024 earnings call. Jack Sinclair, Chief Executive Officer; and Curtis Valentine, Chief Financial Officer, are with me today. The earnings release announcing our second-quarter 2024 results, the webcast of this call, and financial slides can be accessed through the Investor Relations section of our website at investors.sprout.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 comparable GAAP figures.

With that, let me hand it over to Jack.

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

Thanks, Susannah. And good afternoon, everyone. We've seen impressive growth in the second quarter. Our sales grew by 12%, compared to the second quarter of 2023, including a 6.7% increase in comparable store sales and our diluted earnings per share grew by more than 32% from last year's adjusted diluted earnings per share. These results are a direct outcome of consistently executing and evolving our long-term strategy over the past few years.

Our health enthusiast target customers continue to respond positively to our differentiated product assortment and unique shopping experience. As consumer preferences shift towards healthier living, we anticipate there will be even more health enthusiasts in the future than there are today, bolstering our confidence in the long-term potential of Sprouts.

As always, the key factor in all of this is our incredible team. Their teamwork and commitment to excellence are the driving forces propelling us forward. It is an exciting time as we continue to expand, with significant opportunities still to come.

I'll follow up with more later. But for now, I'll hand it over to Curtis to review our financial performance in the second quarter and our 2024 outlook. Curtis?

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

Thanks, Jack, and good afternoon everyone. For the second quarter, total sales were \$1.9 billion, up \$201 million or 12% in the same period last year. This increase was driven by comparable store sales growth of 6.7% and the addition of new stores. For the quarter, we had a healthy balance across all of our key comp drivers; traffic and ticket, e-commerce and brick and mortar, new and older stores, as well as strong results in all geographies.

E-commerce sales also increased by 30%, representing 14% of our total sales for the quarter, highlighting our commitment to meeting the evolving needs of our omnichannel customers, however they choose to engage with Sprouts. In addition, Sprouts brand contributed 22% to our total sales for the quarter.

The company's sales performance was strong across all categories as well. We focused on improving stock levels, introducing innovative products with healthy attributes, getting the right assortment locally, and adjusting planograms, leading to improved performance in our physical stores along with continued steady e-commerce growth.

In particular, during the second quarter, we benefited from early and strong seasonal produce, and saw the business strengthen more than anticipated with this kick-off of summer. In the second quarter, our gross margin was 37.9%, approximately 80 basis points higher than adjusted gross margin for the same period last year. This improvement was mainly due to our better performance in managing our inventory, as well as benefit from promotional optimization and sales leverage in our supply chain.

We're pleased to see that the investments we've made in our inventory systems, data, and processes over the last several years have given the teams the tools they need to drive these results. SG&A for the quarter totaled \$556 million, an increase of \$63 million, or approximately 20 basis points of deleverage compared to adjusted SG&A from the same period last year. This deleverage is primarily due to spending against our planned \$15 million of strategic investments in 2024, and the pressure we continue to feel from new store openings as we grow.

In addition, our strong sales have resulted in increased e-commerce fees and higher incentive compensation for our teams, partially offset by leverage from these higher sales. Store closure and other costs totaled approximately \$3 million for the quarter. These are primarily related to ongoing occupancy costs from our 2023 store closures. Depreciation and amortization, excluding depreciation included in the cost of sales, was \$31 million.

For the second quarter, our earnings before interest and taxes were \$127 million. Interest was positive \$139,000 due to the paydown of our revolver and our invested cash. And our effective tax rate was 25%.

Net income was \$95 million and diluted earnings per share were \$0.94, an increase of 32%, compared to adjusted diluted earnings per share from the same period the prior year.

Our strong and healthy balance sheet has been the foundation of our financial performance. Year to date, we generated \$311 million in operating cash flow, which enabled us to self-fund our investments of \$89 million in capital expenditures, net of landlord reimbursement, to grow our business.

With our robust cash generation, we also paid down all \$125 million of our outstanding revolver and returned \$104 million to our shareholders through purchasing nearly 1.6 million shares. We have \$585 million remaining under our new \$600 million share repurchase authorization. At quarter end, we had \$177 million in cash and cash equivalents, no outstanding borrowings under our credit facility, and \$20 million of letters of credit.

Turning to our outlook, for the full year, we expect total sales growth to be between 9% to 10%, and comp sales in the range of 4% to 5%. We plan to open approximately 35 new stores with the majority of our remaining openings in the fourth quarter. Adjusted earnings before interest and taxes are expected to be between \$445 million and \$455 million. And adjusted earnings per share are expected to be between \$3.29 and \$3.37, 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 more color, we expect gross margins to be up in the second half in-line with our first half margin expansion as we expect to maintain our recent improvements.

For the year, we expect continued pressure on SG&A due to ongoing wage and benefits pressure, new storage deleverage, and our strategic investments. In the longer term, we remain focused on cost management and looking for opportunities to mitigate these cost headwinds. For the third quarter, we expect comp sales to range from approximately 3.5% to 4.5%, and adjusted earnings per share between \$0.71 and \$0.75.

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

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

Thanks, Curtis. We are optimistic about the momentum of our business and the path towards expansion. Our team is more aligned than ever and is committed to winning with our target customers through our differentiated assortment and unique store experience. Moreover, we look forward to the future and the opportunities that loyalty, enhanced personalization and expansion will bring.

While the second quarter yielded exceptional results, we recognize that a significant work ahead. We are unwavering in our focus on collaboration and execution to unlock Sprout's full potential. We are making great progress in becoming our customers' go-to destination for health and wellness products. Our unique product assortment is curated specifically for our target customers and sets us apart due to the attributes, freshness and quality we deliver.

We continue to see customers seeking the type of products and experience we offer. In our second quarter, we saw increased frequency from our existing customers, as well as growth in new customers. Our foraging team continues to drive our unique assortment through both Sprouts brand and emerging brands on our In-store Innovation Center. Sales continue to grow in this space, and we have a strong process to bring the best products quickly to our shelves.

One such successful product was Cymbiotika, a new line of supplements highlighted on the Innovation Center, allowing us to educate customers about the product's benefits. In addition, Sprouts' brand continues to expand with more than 200 new items released through the second quarter, resulting in growing comp sales above the company average.

In addition, we've been investing in our category management capabilities to support our merchants and we're seeing strong performance from that investment across our business. The teams are using this improved capability to make stronger assortment decisions, merchandise more effectively in store, and improve the online customer journey. As a result, we're seeing better performance in category resets.

On the store experience fronts, we have strengthened store operations and fortified our supply chain foundation. The IT, supply chain, and operations teams have collaborated to improve our inventory management with new programs, processes, and tools. These improvements have empowered our store team members to manage fresh inventory better, improving freshness for our customers and significantly improving shrink.

Our merchandising, marketing, and operations teams are collaborating to deliver unique events that create a distinctive store experience. During the second quarter, we held a unique Cherry Festival. The event, not only promoted the cherry season in produce, but also featured nearly 40 Sprouts brand products such as dark chocolate cherry popcorn, cherry blossom lemonade, and cherry-infused deli meals and marinades throughout the store. Our marketing team leveraged our social media and digital platforms to create buzz and our operations team brought the event to life in store with creative displays and sampling to create a one-of-a-kind Sprouts experience.

On the marketing front, we're excited about the increased traffic and brand awareness driven by optimizing our media mix and targeting our customers through creative partnerships with influencers and celebrities. We will continue to take a regional driven approach to our media strategy and refine our personalization efforts to create a more engaging customer experience.

On loyalty, we recently started the beta test of the Sprouts reward program in Tucson and Nashville, one older market and one newer market. We're in the test and learn phase of this project, as we gather feedback from our team and customers. We're very early in our journey to build a loyalty program that excites and engages our customers, while increasing their share of wallet with Sprouts.

Given our business momentum, we're eager to expand into more communities and provide access to even more health-focused target customers. We continue to improve our site selection process and are pleased with the results from our 2024 openings thus far. We've seen strong openings from sea to shining sea.

We're customizing our grand opening approach to establish stronger local connections. This involves focusing partnerships with local news stations to drive awareness and excitement of Sprouts joining the neighborhood. Our plans include unique community engagement activities for each store opening. For example in Bakersfield, California, Sprouts participated in the Earth Day Festival and distributed confetti made of seeds and basil plants to all the attendees.

In Aberdeen, New Jersey we invited important community members to join us including Aberdeen native, Laurie Hernandez, a former Olympic gymnast. We're also excited to leverage our recently announced partnership with the Southeastern Conference to support female athletes while increasing our brand awareness in many emerging markets where we are building new stores. We will open approximately 35 new stores by the end of the year, with more than half of the remaining openings in the fourth quarter.

Despite the challenging development environment, the real estate team is doing a terrific job. Given the success of our new stores, we are dedicated to expanding our brand with over 110 approved new stores and more than 70 executed leases in the pipeline for the next few years. Our success wouldn't be possible without a winning culture and a talent engine capable of supporting growth through the recruitment, development and rewards program that strengthen team member retention.

We continue to invest in our culture and have better aligned our total rewards program to our business performance, incentivizing our teams to take ownership of their business and participate in our shared success. We're proud that every team member in every store can earn a bonus with strong sales performance and we believe that collectively these differentiated incentive programs are motivating our team members to deliver outstanding customer experiences and contribute to our business momentum.

In closing our second-quarter results have bolstered our confidence in our strategy. Our focus on our target customers will unlock the full potential of our business and prepare us for the future. We're dedicated to maintaining a high level of execution, responding to opportunities with urgency, and investing in long-term sustainable earnings growth.

Our teams are motivated by our progress, the challenges that await us, and the even greater opportunities on the horizon. We're excited to share our progress and connect with many of you in the coming months.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Heinbockel, Guggenheim.

John Heinbockel - Guggenheim Securities - Analyst

Hey, Jack, maybe can you talk a little bit through the foraging process, right? Because I know the key to what you are doing is not having product overlap with Walmart or Conventionals. So maybe walk through that, finding that product, getting exclusives for some period of time, or you know, and then thinking about how you want to -- if you want to discontinue items that have gone too mainstream?

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

Yeah. The foraging team, we put that together a couple of years ago, and that team have done a really amazing job in terms of finding products that are not sold anywhere else. I think I've said in the past that there's some really interesting entrepreneurs in the country who are bringing a lot of interesting products, but we're getting more products than actually we can put on the shelves at the moment. Because we've become a bit of a go-to place for people to bring products to the market.

And things that are really focusing in on those type of products with appropriate ingredients, no additives, none of the bad stuff in product, and a lot of positive ingredients. And that's something that they've been working very hard on.

The process itself is they're spending a lot of time going around all the shows around the country, making ourselves available. We have open sessions, where people can bring those products to us. And we pitch slams we call it, and these pitch slams have been bringing us a lot of interesting products. And the exciting thing for us is I think we can be a stepping stone for a lot of these people to in time two years or three years down the line, go somewhere else with the product.

We're very comfortable being the kind of the beta test for these kind of products, get things started, and have that differentiation. The innovation sensor that we put into the store allows us to put products that aren't being sold anywhere else straight into our system quickly. And if they sell, then probably about 25% of them move over quite quickly into the main fixtures.

And in due course, those products will disappear from our business in a few years down the line, as new products come in behind it. And we're very much encouraging this entrepreneurial industry to see Sprouts as the destination for this product.

We watch a lot of what's happening online as well, some of the online businesses that tend to start some of these interesting products. So it's a combination, the teams come together as a combination of searching around specifically to shows, the pitch slam operation, checking out what's happening online with some of the direct-to-consumer products that are launched in this space. And that's coming together pretty well for us, John. Thanks.

John Heinbockel - Guggenheim Securities - Analyst

And then secondly, maybe as a follow-up, what's your thought on when you'll know enough on the loyalty program to expand? And I know, right now, it's a points-based system, right? I think 2% back basically.

Any early thoughts on from customers? The structure is right, do they want to see something else or different? Do you think you need to change it before you go into new markets? What's your take on that?

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

Well, it's very, very early, days. We've clearly got a lot of thoughts on this one, John. We've been spending a lot of time trying to get this right. There's been a lot of work behind the scenes to make sure the technology behind it works effectively and the customer experience is seamless.

We've been in three days in the two markets that we're in, and they've worked very well for the three days that we've been operating. So we're encouraged by the start as much as anything else, the technologies worked, which is always something that we spent a lot of time making sure it works.

As this evolves, the key is to get data from customers. When you're a specialist, kind of retailer like we are, and a targeted retailer with a limited customer base, we have to understand that on a personal level, much more information and getting that data is the key to the work going forward. And then we'll be able to create this feeling of speciality amongst our customers.

We've got a very unique proposition, and we want people to feel very special by being part of this kind of loyalty club almost is the way I would describe it. We'll see how it goes. We're getting the data.

We're very pleased with the start, very pleased with the work that's been done across the IT operations, and marketing teams to make this thing come alive. And we'll be in a better position in the next two or three board meetings to kind of move on from that, to tell you a little bit about how we see this going forward.

John Heinbockel - *Guggenheim Securities - Analyst*

Thank you.

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

Thanks, John.

Operator

Leah Jordan, Goldman Sachs.

Leah Jordan - *Goldman Sachs - Analyst*

Thank you. Good afternoon, Jack and Curtis. Great job to you and the entire team.

I want to start off on the new store growth. It sounds like the majority of the stores still to open this year will come in the fourth quarter. I think previously you were talking about the back half. Just curious, was that really just a clarification point at this point in the year or are you seeing some slippage on timing?

And as you build into 2025, I know it's a little early, but there are long lead times now. How are you thinking about new store growth then? Should we be caught up by the fourth quarter, and we're on a pretty steady cadence into next year? Or what's your visibility right now?

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

Yeah. So Leah, I think this year, a little bit of clarification just to make sure that we get it right by quarter for you and a little bit that this is bit of a challenging environment, I think the interest rates staying higher for longer is creating some timing challenges. I think there's developers are not in a rush to develop when the interest rate is as high as it is. And then the economics are more challenging when it stays that high.

And so, it makes it a little bit challenging. We have seen some slippage. So there is some caution in there to make sure that we get the quarters right, and then we are seeing some slippage.

Overall, I think those things just move and move into or move out further. We're not ready to guide for next year, but I think those challenges will persist until the interest rates come down and probably come down somewhat dramatically. We'll have more updates, obviously, on the next call as we're thinking about next year, but the pipeline's healthy.

We have 110 sites approved from a real estate committee standpoint and over 70 signed leases. So we've got a lot of strong organic growth ahead of us. And we're just trying to navigate the situation.

I think the other thing I would just add is we're not going to compromise on the quality of the sites we pick, of the development and the building itself. So we're going to be choosy, we're going to do it the right way. And if that means, we don't quite get to 10% similar to this year, so be it. But we'll have some more updates for you next time.

Leah Jordan - *Goldman Sachs - Analyst*

That's very helpful. Thank you. Okay.

So then just switching over to gross margin, again, another quarter, really solid expansion here. You guys have been doing that for a long time now. I know there are a lot of company-specific factors that are driving that, which is great to see that you highlighted in the prepared remarks.

But I think just at a higher level, would love to hear you guys kind of discuss how you think about the puts and takes between letting all those tailwinds flow through to the bottom-line versus reinvesting for the long term. You know, how do you think about those trade-offs?

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

Well, from a pricing point of view, Leah, we spend a lot of time making sure we're at the right price, as you kind of identified in your question. There's quite a number of things that are part of us being a young and mature business that we're working our way through. I think, shrink is a good example of the progress that we've made on that and there's further progress to be made.

There's a number of things that we can do to continue to make progress on gross margin and we're working our way through that. How do we think? We're going to invest appropriately in our business going forward. The one thing that we don't think is appropriate to invest is the gross margin level on pricing, because we've got this different, I think we've established ourselves now as this differentiated assortment which gives us, I think a position that we can control our own margins going forward and that's something that's a good place to be.

We haven't -- as you can see from our top-line, it doesn't seem to be something that's constraining our top-line in terms of what we're working at the moment. And I kind of see that being the trend going forward.

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

And I just added that, Leah, yeah. As long as traffic is healthy and we're seeing units stabilized, which they are, and they flattened out, we're going to let the elasticities dictate how we price our differentiated assortment. So we feel like we're in a pretty good place right now, and we'll watch that closely and manage it as we need to.

Leah Jordan - *Goldman Sachs - Analyst*

Thank you. Makes a ton of sense. Appreciate it.

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

Thanks.

Operator

Mark Carden, UBS.

Mark Carden - *UBS Investment Bank - Analyst*

Good afternoon. Thanks so much for taking our questions. So to start, even with some of the macro uncertainty out there, your comp is obviously holding up really well. I know you guys shed some of your coupon flippers, but are you seeing any pressure from the lower end of your current customer base?

Or does your focus on serving key attributes really just keep you more in play than others and you see customers just prioritizing more spend on your assortment?

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

Yeah, I think we lost the coupon clippers long ago, if I'm honest, Mark. So that dynamic, which is clearly a real dynamic in the marketplace at the moment, doesn't seem to be affecting us. So the thing we've always said is that the nature of our assortment, whether it's attribute-based, whether it be keto, or paleo, or vegan, or vegetarian, or dairy, or non-dairy plant-based, all those trends, if you get into that space and your food purchase you can tend to stick with it almost irrespective of what the broader economic circumstances around you are.

And I think that's what's given us a little bit of a moat here in terms of our customer base and their dietary needs and their dietary requirements. However, they're coming at it. And one of the things we're working hard at is to understand that even better as we do work on this personalization work. But more and more we're seeing that our customers are resilient to the external environment that's going on around them. And so yeah, we're feeling good about that.

Mark Carden - *UBS Investment Bank - Analyst*

Okay, great. And then it sounds like you're making further progress with your marketing message in your newer markets. How did your comp compare in new geographies versus legacy geographies in 2Q when you think about similar vintages? Did the gap narrow at all? What do you think on that front?

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

I think our comps generally comes down to really age of store. We're seeing really strong comps from our newer vintages and we tend to be a little heavier weight into the non-established there with our pipeline being kind of 50/50 and just not a huge base of stores in those markets.

So a little bit stronger comps in those geographies, but generally, from Q1 to Q2, it was strength across the board. All regions improved, and we have a really healthy balance across the entire country.

Mark Carden - *UBS Investment Bank - Analyst*

Great. Thanks so much. Good luck, guys.

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

Thanks, Mark.

Operator

Rupesh Parikh, Oppenheimer.

Rupesh Parikh - *Oppenheimer - Analyst*

Good afternoon. Thanks for taking my question. Also congrats on a really strong quarter.

So I just wanted to go back to the comp out performance. So now you're basically comping almost double your long term algorithm for low single digit comps. I guess what do you attribute to, I guess, the overperformance versus your longer-term algorithm? Then how do you guys feel about the sustainability? Because I know in Q3, you do expect the sell versus what you just reported on the comp line.

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

Yeah. So on the acceleration front, it was just, I mean, we had a really strong quarter across the board. You know, everything really worked in Q2. We got an early produce season and then the strength of the season was good throughout. We really saw a step change in the business as we got into the summer months and that was really where it took off.

What do we attribute it to, I mean, I think it's the same things we've talked about for several quarters running. I think we have the right strategy that really works for our target customer. I think the teams are doing a great job executing and collaborating to bring it to life.

And then we put a lot into the team, and the culture, and winning begets winning. And it's really good energy and a good vibe in the stores and the store experience.

So a little bit of everything's working. We had some tailwinds, like I said, with the seasonal piece. And then as far as the guide goes, we don't expect everything to be perfect forever. Something will go bump in the night.

In Q2, the things that were working stayed working and the things that were struggling a little bit got better. But it's a pretty rare moment to have everything working all at once. And that's kind of where we were in Q2. So we're going to plan our business appropriately, towards the high end of that low single digit algorithm. We're going to manage our costs as a result, not get too over egged. And if things continue great, then we'll have some upside and we'll let that drop to the bottom-line.

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

And I think the other thing, you touched about the micro environment here, is I think the sector of the market is just growing a little bit faster than maybe we all thought it would. I think this attribute-based sensitivity to ingredients, health enthusiast, customer-conscious consumer, I think there's just maybe just been a little bit of growth on that and we've probably benefited from that as well.

Leah Jordan - *Goldman Sachs - Analyst*

Okay, great. Thank you. I will pass the line.

Operator

Michael Montani, Evercore.

Michael Montani - *Evercore ISI - Analyst*

Hey. This is Mike. Thanks for taking the question. I just wanted to confirm on the margin side, it sounds like you all were looking for a similar level of gross margin expansion in the back half of the year. So I just wanted to make sure I understood the drivers of that piece of it. And then also, if I'm seeing this right, it's about a flattish EBIT margin, so then anticipating SG&A dollars grow at a similar pace as well. So, just hoping you could help out with that?

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

Yes. Mike, that's spot on. We've been in the mid-80s of margin expansion on the gross and expecting that in that range for the second half, pretty consistently by quarter. And then the offset with SG&A and the pressures were experiencing that.

Michael Montani - *Evercore ISI - Analyst*

Got it. And then maybe on the comp side, if I could, if you were to parse out new store contribution as well as Uber Eats, I was thinking about new stores, maybe 150 bps to 200 bps, and then another, call it 100 bps, 150 bps from Uber Eats, but just wanted to see if there was any incremental color that you could share on that front.

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

Yeah, I don't think we'll give specifics. I would say it's really been strong across the board. Again, it was really healthy. Brick and mortar really was the piece that accelerated in the quarter and we had some traffic acceleration largely in brick and mortar. The e-comm business has been pretty consistent from quarter to quarter for us, so really healthy strong across the board, really pleased with how the comps coming in again new stores are performing core stores are performing. It's been a nice balance for us.

Michael Montani - *Evercore ISI - Analyst*

Okay, great. Thanks for taking the questions and good luck.

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

Thanks.

Operator

Ken Goldman, JPMorgan.

Ken Goldman - *JPMorgan - Analyst*

Hi, I think that's for me. Is that for Ken? We'll see in a second.

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

Yes. Hi, Ken.

Ken Goldman - *JPMorgan - Analyst*

hi, guys. I just had one question. I don't know if you can answer it, but obviously things sound terrific across the board. A couple of questions I am getting are really on the news stores into next year and if there is any chance that you guys can give us any kind of color as to what you meant by what you've said last quarter in this quarter about interest rates and maybe some challenges in terms of the timing there?

I know you're not quite prepared to talk about next year yet, but I think some people are kind of looking for any kind of sense of rough magnitude as to what those comments should have us think about in terms of incremental store count/ Thank you.

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

Well, we'll be much clearer in the future. But we've got 110 leases -- stores signed off and over 70 leases signed. The comments that we've been making around interest rates are the timing in which we can get these stores opened. So we've got a huge pipeline ready to go, and we're in good shape from that point of view.

And that pipeline continues to expand, as we've talked about every quarter going forward. So we're going to build a lot of new stores next year. The absolute number we're going to be clearer about to the next meeting. But there are some pressures in terms of because of interest rates, the speed at which development -- all of our programs are built to suit at the moment, which is creating some delays in terms of us not opening.

The reason we've got more opening in Q4 than I would have liked is because some of these things have just been delayed on the back of some of those challenges that we faced. The team are doing a terrific job getting these things opened. I'm really proud of the work that we're making. And as I say, we'll be clearer about that going forward.

Curtis, do you want to add something to that?

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

Yeah, Ken. We're not going backwards from where we are. It's going to be in the same neighborhood, and it'll just be a question of the tail-end of next year as the timing becomes more clear, just how many we can do specifically.

Ken Goldman - *JPMorgan - Analyst*

That's helpful. Thank you.

And then I heard you mention a little bit about traffic accelerating. Can you just give us a little bit of detail on what you saw from AUR and basket size trends during the quarter? And then very quickly, if you have any comments on 3Q comps to date, if they're more or less in-line with your guidance?

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

Yeah, so on the kind of traffic ticket side of it, yeah traffic accelerated. So 6, 7 comp was, you know, call it -- it was a little bit almost 50-50, but not quite a little bit more basket than traffic. It's an AUR and traffic story. The units have kind of gotten themselves back to flat, still just barely negative in the second quarter.

So we feel like we are stable with that low single-digit inflation, stable unit story. That's kind of how we expected to play out going forward; traffic in AUR, and then flat units as far as the guide goes. And the second piece was --?

Ken Goldman - *JPMorgan - Analyst*

Just 3Q comp to-date if it's more or less in-line with where you've guided.

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

Yeah. You know, we're in good shape here to start the quarter. As we said, we're seeing a strong summer and that's continued end of July and we're just curious to see as we get back to school. It's kind of a shift in our business and the types of products and events we're running and it's really where we saw the comp take off last year. So we're curious to see how we'll have that over the next, call it four to six weeks as the different geographies go back to school.

Ken Goldman - *JPMorgan - Analyst*

Thanks very much.

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

Thanks, Ken.

Operator

Robby Ohmes, Bank of America.

Robert Ohmes - *BofA Securities Inc - Analyst*

Thanks for taking my question. My first question is just can you -- either Jack or Curtis, remind us the profitability of e-commerce? I mean, it did accelerate sequentially again. And it's up nicely in penetration year over year. Is that also supporting gross margin?

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

Yeah. I think it's -- the profitability bottom-line, it's just slightly dilutive because of the fee structure. But on a basket basis, they're typically larger baskets. And so stronger net dollar profitability and a little bit diluted from a rate perspective.

Margin rate-wise, generally the mix is pretty close from brick and mortar to online. There isn't a material difference in margin rate. So it's not a huge story or driver within the gross margin story.

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

And I think that's fine. What Curtis said there in terms of the mix is quite unusual. Our mix of fresh produce in our e-comm business is probably much stronger than you would find in most food retailers that are using that. So that encourages our assortment and our product offer is being very thoughtfully used by our customer base. And there's a confidence in what we sell, which gives us a lot of confidence in our assortment going forward.

Robert Ohmes - *BofA Securities Inc - Analyst*

Got you. That's really helpful.

And Jack, I think you mentioned the regional merchandising opportunity. Can you remind us where you are at now on regionalization of assortment and where you think that could go?

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

Well, very particular in our produce business, which is so important to us, it's very, very seasonal. I was in Colorado over the weekend and the peaches are just arriving, but there's only a few weeks that it'll be snowing soon. So there's only so much you can do in certain times of the year.

So across the country, we've invested in each distribution center in having close relationships with local farmers. So that when things are ready, we are in a good shape to take advantage of that.

And we're working pretty hard at that going forward. Is there further to go? I think no doubt there's further to go. If we can get more commitments to our kind of supply base, giving two, three, four, five year commitments. That's the kind of thing we want to work at, so that we're in a better place to do that going forward.

And some of our individual categories, I think gives us some opportunities beyond produce to do a little bit more than we've done so far. Some of the innovation centers, for example, we've talked to a lot of producers who just haven't got enough volume to supply all of our stores even. And what we work with, what we do with those guys is try and work them into a regional assortment, so we can launch them in a few stores rather than all our stores. And that's something that I think sets us apart and allows us to be differentiated in all sorts of local ways going forward.

Robert Ohmes - *BofA Securities Inc - Analyst*

That's great. Thanks, Jack.

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

Thanks.

Operator

Kelly Bania, BMO Capital Markets.

Kelly Bania - *BMO Capital Markets - Analyst*

Hi. I think that was me. This is Kelly Bania from BMO.

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

Yes, it's you Kelly. Thanks.

Kelly Bania - *BMO Capital Markets - Analyst*

Thanks. So I have a couple of questions.

One, just wanted to ask about promotional effectiveness, and it sounds like that's still a gross margin driver. Can you just help us understand which categories at this stage you are still finding opportunities there to refine your promotional effectiveness, and how much that's contributing to the gross margin, as well as the gross margin outlook that's kind of been bumped here for the back half?

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

So it's -- I won't get to -- it's really across the board, there's not really any huge category story. I think Jack talks a lot about the inefficiency, the immaturity in our business, and I think this is us just better leveraging tools and data and process to make better decisions.

And so the category management we reference in the script, these are pieces that are coming together and we're just getting a little bit more effective and efficient as a group. And so, I think all the merchants are doing a really nice job managing that and getting the target customer appropriate promotions without over-investing in things that aren't going to drive traffic or units.

It was a small driver to the first half, and really, we kind of lapped some of the benefits we saw and started seeing in the middle of last year. So we're not expecting it to be a huge driver in the second half. It's much more an inventory management story, which certainly manifests in shrink, which we've talked about, but also helps us in things like markdown management as we do exit product and bring new product in.

And so we've seen some nice wins on both of those. And again, that's a place where we've made SG&A investments in the last few years that are providing the teams the tools to be able to better manage margins. So pleased with how that's coming along.

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

So specifically to that, each of the merchants are working through basically on elasticity. We talked about this in the number of the calls in the last couple of years. The data that we're getting and trying to understand exactly how elastic certain products are on a promotional basis and using more information, more systems, is back to what Curtis has talked.

As we get a little bit more mature in our business, a bit more mature how we think about it, we're being, I think, smarter about how we invest any money in product promotions.

Kelly Bania - *BMO Capital Markets - Analyst*

That's helpful. And then maybe just to follow-up on SG&A, so we deleveraged a little bit despite comps coming in quite strong. So I was just curious if there's anything impacting SG&A, any pull-forward or timing considerations? Or is it maybe just impacted by the growth of e-comm, which was still quite strong? Just trying to think about how that SG&A came in relative to your plan.

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

Yeah. I think, certainly, e-comm, staying at that 14% level. We're pleased with that. That wasn't exactly what we were counting on as we laid out the year. So there's a little bit of extra pressure there.

Really the big driver, we reset our incentive comp plans for the year based on the performance. And so, you know, paying a lot more bonus to the stores, to the teams, and accruing for that for our long-term incentive as well. So it's been really just catching that up here in the second quarter was one of the one-timers. And then, of course our investments, right?

So we've got another \$4 million of the \$15 million that we spent here in Q2. And so that was a little bit of a drainer as well. So I think to take away the incentive and the investment pieces and we would have been leveraged.

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

And those are investments we're feeling really positive about the fact that we are giving every store, every team member in every store gets the opportunity to turn a bonus and I don't know anyone else that's doing that. That's something we see as a real positive in terms of driving the positivity in our business at the moment.

And these investments we are putting in, because we're putting some good numbers on the Board, it's giving us some space to do the kind of things that we need to do to make appropriate IT investments, appropriate investments behind our personalization work, appropriate investments behind supply chain. It's allowing us to put ourselves in a much better place going forward.

Kelly Bania - *BMO Capital Markets - Analyst*

Thank you.

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

Thanks.

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

Thanks, Kelly.

Operator

Krisztina Katai, Deutsche Bank.

Krisztina Katai - *Deutsche Bank - Analyst*

Hi, good afternoon and congrats on a very strong quarter.

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

Thank you, Krisztina.

Krisztina Katai - *Deutsche Bank - Analyst*

Hi, Jack. I wanted to ask about your produce business, in particular the usual 10% to 15% discount you have relative to traditional grocers. So can you just update us on where the gaps are today?

And then, two, is that we hear a lot of food retailers talk about leaning into the fresh department in particular. So do you see them doing anything differently price wise or merchandising wise to drive traffic or frequency?

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

Well, we've talked about this in the past, Krisztina. We pay a lot of attention to produce pricing. We've been very encouraged by particularly our organic produce pricing. Even the guys are chasing after produce. They're not chasing after organic produce, they are chasing after some of the conventional products.

So what we've found is we've widened our gap in organic produce, which is what our customers, we're well over 45%. I can't remember, did we quote the number?

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

Yeah, personally, we quoted something I'm not supposed to quote.

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

45% of our produce businesses are organic produce. I've said it now. So that's something, and it continues to grow and we're encouraged by it. And so from a proposition point of view, this organic gap's important to us. And I think as we look at that, we're in very good shape against everybody in that space.

We're not seeing a very aggressive environment. There's some occasional aggressive promotions, which people put on the front page of ads. But it's not something, we're well away from that type of customer that's responding to that coupon clipping that we had many years ago.

So our produce pricing's in good shape. Our mix of produce is evolving towards, I think, something that emphasizes our differentiation in being organic produce. We're working very close with growers; growers so that we can get more and more of that available going forward. But yeah, produce is in good shape.

Krisztina Katai - *Deutsche Bank - Analyst*

Got it. And then just as a follow-up, I think you said that you grew frequency with existing customers and then you also saw new customer additions. So, maybe can you talk about what you're seeing purchase behavior-wise with your two-core customer segments that you're targeting? And where you are with them on wallet share today versus even maybe a year ago relative to where you would like to be? Thank you.

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

Yeah, sure. Krisztina, this is Curtis. I think that's a piece that we're excited to get after as we get into loyalty and we gather more and more data, so we can have a more crisp answer there. But certainly, really pleased with the frequency piece. That's a big opportunity for us and how often folks come in and saw that go in the right direction for us.

As far as the two segments, we believe we're gaining share of wallet and everything we look at tells us we are. So really pleased with the direction we're headed on customer engagement. And looking forward to getting even more and more data to better engage with them and tell that story.

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

And it's not -- we still get lots of opportunities to go share a wallet with those target customers. As we've talked in the past, we're talking a really small number, a few crumbs at the table, and we can grow this thing a lot faster than we have been growing over the last couple of years.

And that's where the loyalty and we personalize it. Yeah. Thanks, Krisztina.

Krisztina Katai - *Deutsche Bank - Analyst*

Thanks. Best of luck.

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

Thank you.

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

Thank you.

Operator

Edward Kelly, Wells Fargo.

Edward Kelly - *Wells Fargo Securities - Analyst*

Hi, guys. I think that's me.

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

Hi, Edward.

Edward Kelly - *Wells Fargo Securities - Analyst*

Nice quarter by the way.

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

Thank you.

Edward Kelly - *Wells Fargo Securities - Analyst*

So I wanted to ask about digital. You know, 30% growth in digital is pretty impressive, on top of 25% last quarter. How do you think about where digital penetration can go over time, you know, currently at 14%? You will -- I guess, you know, lab will breach, I guess, as you get into next year. Thoughts around, you know, how you think about the sustainability of the digital growth as well?

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

Sorry, I think you cut out there? Can you --?

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

Sorry, you just cut for a minute. It was a follow-up to the sustainability of what was it you asked about?

Edward Kelly - *Wells Fargo Securities - Analyst*

Yeah, the sustainability of digital growth and where you think penetration can go over time.

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

Okay, yeah, we are very pleased with how our digital business is going in it. It reflects the fact that we're very indifferent to how the customer shops with us. We believe that our assortment and our proposition fits well with our target customers. And they will be an omnichannel who will choose how best to access our products.

We want them in our stores. We want them to come and pick up from our stores. And we want them to get delivery via some of our different mechanisms of getting it to people's homes. That increase, that 14% is something that -- I'm not sure how much, it'll probably tweak up a little bit. I don't think it's going to go over the long term dramatically more than that. I don't see that, and it certainly will be what it will be though, and we'll take what happens, how our customer shapes us in that direction.

We want to understand our customer better and make sure we're reflecting the assortment that's appropriate to that target customer. So the sustainability of our, I think it might tweak up a little bit. And that's not what I would have said a couple of years ago coming out of the pandemic. I think things have changed a little bit and customers are feeling more comfortable about using digital in our environment than maybe they were pre-pandemic.

Remember, we're only at 2% of our sales pre-pandemic, so there has been quite an evolution. I think as we start to understand the customers, that will tweak up a little bit more. But I don't think it's going to be huge.

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

And I just add a little color, it's really all three partners driving it. So it's not all an Uber Eats story. We're really pleased with DoorDash's year two growth. They continue to ramp up.

And Instacart, our longest term partner, has had a great year and is driving growth as well. So it's really balanced across the three partners as far as that penetration jump we saw up to 14%.

Edward Kelly - Wells Fargo Securities - Analyst

Great. And just a quick follow-up on SG&A. Obviously, you've had investment in SG&A this year. Are you at the point where you cycle out of 2024, and we can start to think about more normalized SG&A growth on a per-store basis, like a more normalized comp to leverage SG&A? I know you're not going to get guidance for 2025, but I'm just kind of curious where you are in the investment cycle.

Curtis Valentine - Sprouts Farmers Market Inc - Chief Financial Officer

Yeah, it definitely should be more normalized as we get to 2025. We won't get super specific this early yet on exactly what that looks like, but it's not going to be in the 80% range that it's going to look like here this year. There's certainly some one-timers with investment. There's the incentive comp piece that goes the other way or normalizes back to 100% next year.

So it'll normalize for next year. The underlying pressures will still be there with new stores, with wages, with e-commerce. But again, even the e-commerce people we just discussed will be a little bit muted. We've got our step change here this year of having those partners jump on and that'll normalize a little bit as well. So should be a more normal year next year.

Edward Kelly - Wells Fargo Securities - Analyst

Thank you.

Curtis Valentine - Sprouts Farmers Market Inc - Chief Financial Officer

Thanks.

Operator

Karen Short, Melius Research.

Karen Short - Melius Research - Analyst

Hi. It's Karen Short from Melius. Good to talk to you again. It's been a while.

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

Hi, Karen.

Karen Short - Melius Research - Analyst

It's been a while. So I had a couple of questions related to comps. So can you just give an update on, first thing is cannibalization. The second is waterfall on new stores. And then the third is -- actually this is a little more tangential. When you think looking forward if an assuming Kroger and Albertsons actually does change hands to C&S, how do you think about that opportunity?

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

Sure. So I'll take the first two and I'll leave the third for Jack because he likes to answer that one. So cannibalization, certainly, as we expand the number of stores, we went from 30 last year to 35 this year, there'll be a little bit of incremental cannibalization.

Our pipeline is approximately 50/50, kind of non-established to established. So we don't see a ton of cannibalization in the non-established markets. We feel that more in the established markets. That's playing out about as we expected, and it's a little bit of a drag that offsets.

The second part of your question was just that new store waterfall. That comps have been really strong in the last few vintages, a little bit better than our box economics. They've started a little bit lower from a volume perspective. And we think they're going to get to the right place in the longer term.

I think the only thing I'd note on that comp waterfall from new stores is that -- as they come out a little bit lower volume, they just don't carry the same weight versus the core. So as a penetration to the total, they're a little bit lower but we're seeing nice strong double digit comps as they hit their first year comp.

And now the Kroger and Albertsons, I'll let Jack cover that one.

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

Yeah, Karen. I think Kroger and Albertsons, whether it happens or it doesn't happen, I've really got no idea. I've got no more insight than anyone reading the newspapers like everyone else.

So the way we look at it, both of these companies have got some good brands in all sorts of different markets where we operate and some where we don't operate. And we actually see ourselves as not competing with either of them. So we see ourselves as a complementary retailer.

And I've always talked about this. We're not trying to win traffic from the big conventional supermarkets. We're trying to win a share of wallet of our target customers. And it's not meant to sound arrogant in any way.

But it doesn't matter if we keep focusing in on looking after our target customers and trying to understand them better and grow that share of wallet with that target customer. It almost doesn't matter what the other guys do. If anything, I just want to be as close to them as I can if they've got big traffic. Because we feed off the traffic of some of these higher volume kind of conventional grocers.

So I hope that makes sense. But we're focused in on the customer side of it, not so much of what might be happening corporately with two very big businesses.

Karen Short - *Melius Research - Analyst*

No. That makes sense. And then just a follow up on new store productivity, obviously, it was very high. But how do you think about that going forward, given the heavy weight on new store openings in 4Q?

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

Yeah. I think we never really count on more than what we kind of talked about historically in the approximately 75% range. I think that gets a little better with the smaller square footage and we expect the top-line to be about the same in those new stores, but we don't count on anything more than that.

We kind of take the openings as they come quarter by quarter and then we address it in the reforecast from there. So we are pleased with the new stores and the momentum particularly in the newer markets, and we're happy with the openings we've seen as Jack mentioned from sea to shining sea. So we've seen some good ones on the West Coast, we've seen some good ones in Florida, and some good ones in the East Coast, and it's given us a lot of encouragement for the expansion plan forward.

Karen Short - *Melius Research - Analyst*

Okay, thank you so much.

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

Thanks, Karen.

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

Thanks.

Operator

Thank you. And there are no more questions in the queue for today. I would now like to turn the call over to Jack Sinclair for closing remarks. Please go ahead.

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

Well, as always, we appreciate your interest in our business. Thanks very much for taking some time to listen to us today, and we look forward to talking to you again in the near future. Take care, everyone.

Operator

Thank you for joining today's conference call. You may all disconnect.

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