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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

Erica A Eiler *Oppenheimer & Co. Inc., Research Division - Equity Research Associate*

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

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

Kendall Belinda Toscano *BofA Securities, Research Division - Research Analyst*

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

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

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

Robert Bain Moskow *Crédit Suisse AG, Research Division - Research Analyst*

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

PRESENTATION

Operator

Good day, and welcome to the Sprouts Farmers Market Second Quarter 2022 Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded.

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

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

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

The earnings release announcing our second quarter 2022 results, the webcast of this call and quarterly slides can be accessed through the Investor Relations section of our website at investors.sprouts.com.

During this call, management may make certain forward-looking statements, including statements regarding our expectations for 2022 and beyond. These statements involve several risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. For more information, please refer to the risk factors discussed in our SEC filings, along with the commentary on forward-looking statements at the end of our earnings release issued today.

Our remarks today include references to non-GAAP measures. Please see the tables in our earnings release for a reconciliation of 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 thanks everyone for joining us today. We are pleased with our performance during the second quarter.

We emphasized bringing back a selling culture, improving in-stocks, amping up our merchandising and testing marketing initiatives. This resulted in better-than-expected financial performance including total sales growth of 5%, comparable store sales of 2% and earnings per share growth of 10%. I want to thank our team members for delivering this performance in what continues to be a very difficult environment for them professionally and personally. They live our values every day and bring positive energy to our stores and ultimately, to our customers.

One of our key values is 'love being different', which is ingrained in our DNA and underpins our strategy. It can be seen in the unique products we carry, the layout of our stores and the knowledgeable service provided by our diverse team members.

As we move further away from what we all hope was the peak of the pandemic, these differentiations are being recognized by our customers, and we are pleased to see this resulting in positive top line performance. We recognize the well-documented challenges facing the consumer in the months ahead. However, as we celebrate our company's 20th anniversary, we continue to be confident we're headed down the road with the right strategy and the right team in place.

In a few moments, I'll follow up with more details relating to our recent activities and focus on the remainder of 2022. For now, let me hand it over to Chip to review our financial performance in the second quarter and our current outlook. Chip?

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

Thanks, Jack, and good afternoon, everyone.

For the second quarter, total sales were \$1.6 billion, up \$74 million or 5% from the same period in 2021, driven by new stores and comparable store sales growth of 2%. We did experience positive comp transactions, which is our proxy for traffic. Both traffic and comp sales steadily improved as we progressed through the quarter. We experienced strength in categories where we are most differentiated such as grocery, dairy and frozen, while deli continues to be a shining star as consumers search for healthy and convenient meal options. Our e-commerce sales grew 15%, representing 11.1% of our total sales for the quarter.

Our merchandising and store operations teams are slowly but surely making progress as they partner to bring back the consultative selling culture in our stores by highlighting key items with placement and signage while also supporting them with sampling events. Our goal is to spark interest in purchasing that one extra item for a consumer who we know is having to make difficult spending choices during these highly inflationary times.

Our second quarter gross margin was 36.4%, an increase of approximately 30 basis points when compared to the second quarter of last year. The improvement is primarily associated with shrink and decreased warehouse and distribution costs, which continued to benefit from the opening of our 2 new distribution centers last year. We continue to pass through the increased product cost to retail pricing.

SG&A for the quarter totaled \$462 million or \$26 million higher when compared to the same period last year. Increases were predominantly driven by new stores, rising wage rates, credit card fees and e-commerce fees.

For the quarter, our earnings before interest and taxes were \$87 million, interest expense was \$3 million and our effective tax rate was 26%. Second quarter diluted earnings per share were \$0.57, an increase of 10% over the same period last year.

During the quarter, we opened 2 new stores and closed 3. The 3 closed stores had reached the end of their lease, and we believe that most of their respective customers can be better served by nearby stores in the marketplace. There are no further closures planned for this year. And in fact, we are excited that all but one of our new store openings in the back half are in the new format.

Turning to the balance sheet and cash flow highlights, we ended the quarter with \$289 million in cash and cash equivalents, \$250 million outstanding on our \$700 million revolver, \$25 million of outstanding letters of credit and a net debt-to-EBITDA ratio less than 0. Importantly, during this time of rising interest rates, our interest cost remains relatively flat due to our \$250 million swap in place on our outstanding debt. Our ongoing strength of cash generation fully supports capital investments for growth while also allowing us to continually return cash to our shareholders through our share buyback program.

For the quarter, we spent \$24 million in capital expenditures net of landlord reimbursements and repurchased 2.4 million shares for an investment of \$65 million. Our diluted weighted average shares outstanding for the first half of the year were down over 5% when compared to last year, reflective of our sustainable share repurchase program.

Turning to our current outlook for the full year. We expect total sales growth for the year to be 4% to 5% and comp sales growth between 1% and 2%. Earnings per share are expected to be between \$2.18 and \$2.26. We expect to continue to pass through product input costs and expect a slight increase in gross margins for the full year relative to last year.

On the SG&A front, the back half growth relative to the front half is slightly higher due to the timing of our new store openings, higher marketing investment in Q3 relative to last year, rising supply costs and increased security measures in a number of our stores. In addition, over the last several quarters, it has been extremely difficult to fully staff our stores, which has offset a rising wage rate environment. The good news is that we feel we are finally making real progress in staffing the stores. However, it results in slightly higher total spend.

We expect to open 15 to 17 new stores this year, inclusive of the 8 new stores opened year-to-date. We are slowly making progress towards our strategic goal of 10% unit growth a year and currently expect to open at least 30 new stores in 2023. We now expect capital expenditures for this year, net of landlord reimbursements, to be between \$130 million to \$150 million.

For the third quarter, comparable sales are projected to be in the range of 1% to 2% and earnings per share are expected to be between \$0.49 and \$0.53.

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

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

Thanks, Chip.

We recognize the challenges consumers are facing in this fluid environment and are considering this in our strategic decisions. Inflation, high gas prices and the year-on-year effect of the impact of Delta last year, all contribute to an uncertain outlook for our stores and our customers. In light of this macro environment, we remain proactive, implementing tactics for Sprout's long-term success and a solid back half of the year.

In operations, we're amping up the selling culture and operating a more efficient store with a focus on in-stock. In merchandising, we're highlighting our differentiation and value like Sprouts Brand as well as healthy prepared meals. And in marketing, we are quickly analyzing what works and what doesn't.

I'm excited to see the selling culture reignited at Sprouts. It can be witnessed in the energy in the store with seafood road shows, community events and sampling. And yes, team member contests. Nothing brings back that selling culture more than a little healthy competition among stores. The team members owned this one in the second quarter and reached new goals.

In June, we returned to an in-person, annual SproutsCon festival with 1,200 team members from grocery, vitamins, produce and store managers in attendance. We were enthused to see more than 1,200 vendor exhibitors, representing more than 500 brands, sharing their unique product attributes firsthand. I left inspired by the energy from the team, and I'm excited to see the impact in our stores and on our performance.

As I mentioned on our last call, the operations team continues to improve in-stocks and reduce shrink by leaning on new technology like perpetual inventory computer-assisted ordering or PICA and FIM-fresh item management. By aligning inventory levels to sales demand, dairy and frozen are seeing meaningful improvements and importantly, this is flowing through to better sales.

With the addition of 2 new distribution centers, we're taking miles off the road and benefiting gross margins. Even more importantly, this better serves our customers who are looking to Sprouts for the best quality and value in fresh and organic produce. While we have lapped most of the new DCs benefit in the second quarter, we look forward to continuing to leverage the Florida DC as we expand in that region as well as expand our supply chain as we grow the Mid-Atlantic and California areas.

As we continue to expand our footprint, retaining and developing Sprouts 31,000 team members is key to our future success. Recognizing this, we've taken measures to improve the onboarding experience, enhance our training and fully staff our stores to support our customers and engage our team members. With this focus, we're seeing turnover stabilize and excitement in the organization around the culture building we are doing.

Moving on to merchandising. As the consumer is being pressured by inflation, we are proactively focusing on value across the store. We're driving value through pack and pricing leaning into our great produce pricing, emphasizing our large bulk offering where customers can control their costs, expanding our local produce, which provides more attractive pricing, and running BOGO and vitamin offers to help customers save.

In addition, we continue to move the needle on our Sprouts Brand. Differentiation is key to our product selection, and it's rooted in the value we give to our customers. Our Sprouts Brand does offer entry-level price points, but is more focused on innovation, treasure-hunt experience, wellness or health benefits as well as quality. Some recent releases are pasture-raised eggs, avocado and asparagus fries and medicinal gummies with many more to come this year.

Deli meals, sandwiches and sushi continue to outperform our expectations. As time remains precious for consumers our daily traffic has been up, even after increasing retail prices to keep up with inflation. However, one price that remains fairly constant is our long-standing favorite, our current \$5 made-to-order deli sandwich. It has recently taken off on TikTok, unsolicited, with more than 7.8 million views.

Our in-house culinary team is inspiring change with innovative meal options, including penne caprese in nut-free pesto sauce, salmon with béarnaise and roast garlic brussels and no-antibiotics-ever chicken, salsa roja with chili sweet potatoes and many more to come. We've been adding additional prepared meal cases to our existing store base to support this growth, which is now in more than 85% of our stores.

In addition, we continue to update and add new one-pan meals to our meat department with our proprietary marinades loved by our customers. Marketing is one area we continue to monitor and pivot more quickly as needed. Data shows that the consistency of our paid media messages focused on great prices on the freshest produce is working in our markets and increasing overall aided awareness. However, our aided awareness is still quite low for our emerging markets. With this in mind, going forward, we're over-indexing our marketing spends in our emerging and expansion markets, especially in digital, streaming TV and radio.

When it comes to driving spend, we are growing personalized offers, continuing basket building initiatives and aligning all our channels, social, digital and in-store with consistent messaging for all key events. We've begun to test personalized engagement in categories we own like vitamins and organics and are seeing success.

On the social side, we continue to actively nurture long-term relationships with micro, macro and [mega] influencers across the health and wellness space. On the consumer data side, we continue to understand our target customers better. We utilize 4 key data points: numerator, credit card, customer surveys and e-commerce.

From a digital standpoint, we've increased e-mail subscribers by more than 19%, SMS subscriptions by more than 70% and mobile downloads by more than 30% over last year. Overall, customer counts have been slowly increasing over time, and our customer satisfaction scores remain very high.

We also began testing e-commerce campaigns to attract new customers to our shop.sprouts.com site, resulting in high double-digit sales growth. As well, during the second quarter, we began to accept EBT SNAP for same-day delivery and curbside pickup for orders placed on Instacart. This allows all customers to order fresh and nutritious foods online and enjoy greater convenience, accessibility and affordability.

I'm delighted that our new inspiring women's resource group was instrumental in supporting one of Sprouts new initiatives. We're investing in women's college athletics through the backing of the Big 12 and Pac-12 Conferences, 4 key universities and 50 individual collegiate women athletes in partnership with softball icon, Jennie Finch. Being the first grocery retailer to make this commitment to collegiate athletics and coupled with our sponsorship of the Angel City Football Club, we remain invested in growing and changing the landscape of women's sports for years to come. We're proud to sponsor these great female athletes and look forward to many more strong ideas from our inspiring women's resource group to support our business.

With that, I want to thank you for your interest in Sprouts. We're confident we are working diligently on controlling what we can control in the current economic environment while not losing sight of the long-term plan to grow this unique brand across the country.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Scott Mushkin with R5 Capital.

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

Jack, thanks for some of the detail. So my question really goes to some of the stuff you were talking about at the end there, Jack. Like you talked about the sampling that's returning, the marketing campaigns, kind of what's happened with the sandwich. I think you said \$5 sandwich got -- took off on TikTok, I think is what you said. When we look at the quarter, did you -- could you see any building momentum in traffic? I mean was it -- were you able to actually kind of see some of these things working? And maybe you can point to yes, no and why you might think one or the other.

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

Well, if you think about what we talked about the last time, Scott, we talked about we're seeing quarter-on-quarter the traffic growing, and that's something that we hadn't been at before. So we saw in Q2 another increase in our traffic -- gentle increase in our traffic, but what we're looking for.

With regard to the -- we talked the last time about units in the basket and what was happening to that, and we talked about some of the initiatives we're putting in place to drive those units to the basket. So putting in that -- certainly, deli's been encouraging. The deli meals case that we've put into our stores as you said -- as we talked about, the sandwiches seem to be driving some business for us. So deli has been encouraging. And we've put some equipment behind that to drive both sushi and our meals offer. So that's coming together well, and we're pleased with that.

The in-stock work is progressing, and we continue to work on improving in-stocks across the chain. We've made some progress on that, but we've got more progress to make as we implement some of these systems around PICA and some of the systems that we're talking about to improve the backroom processes so that we can get more installed during the day -- all the way through the day. So that, we made a little bit of progress there.

We talked a little bit about some of the marketing initiatives, which in -- on the [field]. We've got a bit more work to do on that and a bit more learning to do, but we made a little bit of progress on that. So the kind of bucket of things that we talked about and the thing that I'm probably most excited about is post COVID, we've actually been able to get back to some sampling. And this whole idea of sampling new products, sampling fresh produce, sampling some of the innovative products, we're beginning to get that back into our -- it's always been part of the DNA in Sprouts, and we're beginning to get that back. We've got -- again, Scott, we've got a bit more work to do on this, but I'm pleased with some of the progress we made in Q2.

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

And just to clear -- oh, hey, Chip.

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

Yes, this is Chip. Sequentially, we did see some improvements, both slight improvements in traffic, we did see some slight improvements in comps. Obviously, when we talked in April, April wasn't the greatest of the month. So it got better as the quarter went on. The decline in units per basket sequentially in the quarter was slightly better. So we're encouraged by that, but we still have work to do there, but we're encouraged.

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

You must be a mind reader because that was what I was going to follow up with. And then my second question, Chip, probably is directed at you. We talked about what level of comps you guys need to kind of lever your expenses over time. I mean, obviously, this is short term. Is that changing like higher now that the expenses -- it's harder to get people, labor costs are rising. I think you guys just talked about 3%. Are we meaningfully above that at this stage?

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

Well, certainly, as costs rise, you got to need a higher comp to truly leverage. You need a comp that's probably 100 basis points above your cost growth to really drive meaningful earnings growth, assuming you don't have new stores. So we're -- the good news is -- well, the tough is, yes, prices are rising. So cost per labor hour is going up, our supply costs are going up. We're working really hard to manage through those. I think we're in a pretty good place to manage through it for the rest of this year. And then we've still got several months ahead of us that we can start to -- now we're working, what does this mean for next year and where are those pockets that we can find some opportunities to mitigate some of these rising costs, and we're working really hard beginning now on getting ahead of that.

Operator

The next question comes from John Heinbockel with Guggenheim.

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

Jack, let me start with -- you talked about unneeded brand awareness. What are -- in your mind, what are the emerging markets where the unaided awareness is and where you'd like it to be? How big is the gap versus where it is? Obviously, let's not say Phoenix, but some more mature markets. And then is the best way to do this, just densing the store network as opposed to marketing? Or that will just take time?

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

Yes. Well, I -- yes, it will take some time. But let me just kind of try and articulate where we are with regard to emerging markets and more established markets. When we look at stores that we opened in California, stores that we opened even in Colorado, even in -- and in Arizona, we've got a strength and we've got a densification there. So we kind of hit the ground running a bit faster there because there is unaided awareness. And that awareness initiative is a big part of what we're doing in Florida, a big part of what we're doing in the Mid-Atlantic and a big part of what we're doing in Texas as well in Dallas in particular. So driving awareness in those markets, marketing's a part of it, densification's another part of it. We're opening a lot of stores in Florida at the moment following on from the DC investment last year. And that's certainly helping us get awareness across the marketplace.

So I would say it's a bit of both. Densification clearly makes marketing more effective and more efficient. And it's something that we're right in the middle of. The relative strength of awareness is pretty -- I've not got the empirical number at the top of my head, but the difference between awareness in California and Florida is pretty significant. Maybe 20, 30 points before.

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

How many points?

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

20 to 30 points would be off the top of my head a number that I would kind of quote.

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

Okay. And then maybe following on that, maybe talk about the -- Florida in particular, right, the opportunity there, right? Everyone seems to be comping extraordinarily well in Florida, right, if you look at the Publix' results. When you think about your ultimate opportunity, right, to store out the state, yes, how would you size that up, right? Tripling, quadrupling in store count, is that too optimistic?

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

Well, we'll not be tripling our store count in the short term, but we'll certainly be doubling our store count in a relatively short space at time. As you know, what's happening in Florida. John, there's a lot of people moving there, so there's an influx of people. And there's an influx of people who are in our target customer base, people who are interested in healthy products, more interest in nutrition, more interested in fresh foods. So the people that are moving to Florida kind of are in line with our target customer base. So we're very confident about -- very encouraged by the opening of the new DC in Orlando as that kind of builds the opportunity for us to create great fresh foods.

And the fact that we're sourcing a lot of product in Florida is allowing us to work pretty well with the growing community in Florida. And we've done some really nice work on the seafood space on -- seafood in Florida, which I'm encouraged by the way the team are working on that. So yes, we're very optimistic about Florida. That's probably going to be our fastest-growing market over the next 2 or 3 years.

Operator

Our next question comes from Kelly Bania with BMO Capital.

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

Just I guess a quick question is on inflation. Is it fair to assume that your inflation is kind of similar to the industry food at home CPI numbers that we're seeing? Or could it be above or below? And then just had a couple of follow-ups.

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

I mean it's, Kelly, by and large in line with what you're seeing from the CPI. We do have a slightly different mix. And you're seeing a little bit -- the volatility in produce means it goes up above and then below. There's a volatility around the produce pricing, which probably is more extreme in our business than you'll see in other people's businesses. And things like vitamins and HABA where we've got a smaller proportion, you'll see a different mix flowing through. But overall, I think you can take the assumption that we're by and large in line.

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

Okay. And I guess just a follow-up, I mean, it sounds like the traffic is turning positive. But how are you looking at or thinking about market share? I mean some of the data we're looking at is natural sales kind of in the high single-digit range at least. Is that at all concerning to you? Are there still customers that you think you're just shedding as a result of the strategy? Or just how do you think about kind of market share? Or is that really not important as you kind of analyze the business?

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

Well, let me tell you how I think about market share. I think we sell very different things to what everyone else sells. So if I compare our market share to our grocery, it really is pretty indifferent what's happening in the grocery space on market share across the traditional grocery space because ultimately, if they're doing well or badly, it doesn't help us one way or the other. The important thing for us is are we winning share of wallet with our target customer, and that's how we measure. We've got a bit more to do to measure that better. But fundamentally, market share that I look at, that you guys are looking at, is looking at a whole lot of things that either we don't sell or don't want to sell.

The only comparable sets of products that we have is our produce business, so we watch that carefully. Is our produce business growing at the rate that it should be? And we made a little bit of progress on that in Q2, and we've got more work to do there. But we sell a lot of bulk that nobody else sells. I don't know how that comes into market share. We sell a lot of vitamins and HABA that a lot of other people don't sell. So I'm kind of -- maybe the end of your question, we don't worry about it too much. We worry about are we looking after our customers and are we growing share with those customers and doing the right things with them.

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

Okay. Fair enough. And if I can squeeze one in on unit growth, I guess. It looks like you said about 30, I think, for next year. So that 10% growth target, I guess, is getting pushed out until '24. But is that the right way to think about it, like 7% to 8% unit growth? Or are there any more store closures planned? Could you help us just kind of understand the total picture there?

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

Yes, Kelly, this is Chip. So as we said in the script, we talked about at least 30 next year. We're going to continue to work hard to try to get that number higher. That being said, as you know, we've been bringing the number down in the last year. So we don't want to overpromise and underdeliver from our own perspective and for the investment community perspective. So we've -- we're pretty confident we can do at least 30 next year. We're going to drive to a higher number. But for now, I would think about it being 30. And as we get into 2024, we're really aiming hard to be at that 10% unit growth by 2024. And in fact, we'd like to get there next year, but for right now, we're banking on 30-ish.

Operator

Our next question comes from Ken Goldman with JPMorgan.

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

I wanted to ask -- one of the questions that I get on Sprouts is when will the company show a little bit more, I guess, consistency for lack of a better word, in terms of its earnings and its general fundamental performance. And I think maybe this quarter would be "good" versus your expectations and some others have been kind of back and forth. So I guess, obviously, every company's goal is to have consistency. But is it a high priority for you at this time? Or is it really just, hey, you want to just put everything into the business and kind of see how it goes? I guess I'm just kind of asking are we at a period where investors can finally a little bit feel like there's some reliability in some of the numbers that are coming out there rather than some of the back and forth that we've seen. I hope that makes sense.

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

Sure. And we certainly would be aspiring to be more consistent than we've been in the last couple of years. Having said all of that, there's been an unprecedented level of volatility, not just in our business but maybe across the marketplace. Now I don't know what's going to happen going forward, Ken. We're certainly very clear about what we are aspiring to do and what we're trying to do. And we want to get to that consistent measure of new store growth and comp growth that we've talked about. And that will deliver the kind of numbers.

The one consistency we've got is our margin within that context. So we're feeling that we've put the building blocks in place and the performance of the business, I would expect as in a normalized environment to have been and will be much more consistent going forward.

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

Okay. And then as a follow-up, you talked about how your portfolio differs from some of your competitors. And clearly, it does. So maybe this isn't quite the most relevant question, but I wanted to get your sense of the rationality in terms of pricing, promotions, of some of the -- maybe you won't consider them direct competitors, but other food retailers sort of in proximity to you. Are you seeing a generally rational environment given the combination of both higher inflation that needs to be passed on and maybe a little bit more challenged consumer out there?

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

Yes. I think what we've seen so far is that there's such a pace of volatility in the cost prices that across the food retail space people have been passing on the unprecedented pace at which we -- I don't think anyone's had to face with us since the 1980s. I'm probably the only guy old enough to remember how to deal with some of this stuff. But you have to pass on the -- what people have been doing is passing on the cost prices that have been coming through. We've not seen any irrationality in that.

Supply chain remains a bit of a challenge still for people, so it's unlikely you're going to see very aggressive promotions. Having said all of that, what will happen going forward -- and this is outside of our space, what will happen going forward when the consumer comes under. And there's some -- who -- what's going to happen at the end of the year as people run out money and run out of -- if the recession everyone's talking about happens, what is likely to happen? I think it's unknown going forward, Ken. But my gut feel is that there will be a rationality in it.

We certainly got every intention of planning our business on the basis of not investing any margin for promotions or for a competitive environment that, quite frankly, as I said a little bit ago, we're less worried about what other people do, we're more worried about making sure we're providing the right value for our customers. What does that mean? It means being aggressive and assertive in our relative value in produce, and making sure we're very clear on the rest of our portfolio that we're taking account of elasticity, that we're watching what happens to volumes when we change prices and making the necessary adjustments within our own environment as and when this evolves.

Operator

Our next question comes from Edward Kelly with Wells Fargo.

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

I wanted to ask you about the acceleration in store growth that start -- kind of starts in '23. And how much of what we're seeing today around sort of like less items in the basket, right, and that elasticity issue that we're seeing with a tougher consumer and inflation, what role that's playing in sort of like when new stores or you expect to break even in terms of like an earnings contribution? And then as we think about the stores next year, what are you thinking about from like a new store productivity standpoint related to the stores that we'll be opening?

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

So Ed, this is Chip. On our IR deck today, we actually have a store profile in there that's slightly different than what's been out there in the past. Not much different, but slightly. And we're still -- we're essentially targeting about, call it, \$13 million in sales in year 1. We think that, that will grow in the next 5 years, will grow 20% to 25%. They're generally breakeven in the first year. By year 5, they're doing an 8% EBITDA margin. And they're doing 30% to 35% cash on cash by year 5, and you're looking at that.

And that's incorporating the most recent or more current cost to build because there has been -- despite the fact we've brought the square footage down and our initiative really to bring the cost down, which we've done, the costs in the industry have gone up and gone up somewhat to about \$3.8 million for us on a per box basis. So hopefully, if you go look at that, we'll get a better feel for it. That being said, it's still really good returns. It's returns against a weighted average cost of capital. It's single digits, and we feel confident we can continue to build those and hopefully be fairly aggressive on store growth.

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

Great. And just a follow-up on the expense side. I'm curious, 2 things. One is the cadence of SG&A as we think about the rest of the year. Typically, I think Q2 is higher than -- sorry, Q3 is higher than Q2, and then Q4 is sort of lower than Q3. Wondering if that's right. And then just going forward, as we think about 2023, if we're thinking about sort of 7% to 8% sort of unit growth, I know you're still sort of working through like opportunities to be efficient from a cost perspective, but it certainly seems like there's a chance here that you could see, I guess, actually dollar growth, a little higher than that. I'm just -- I don't know to what extent you can help yet around that, but any color would be great.

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

Yes. As it relates to this year, the dollar growth in the back half is going to be higher year-over-year than the front half. Some of that is -- we were severely under invested, I would say, in marketing last year in Q3. So it's a big chunk of that in Q3. And we had a teeny bit of marketing slide from Q2 to Q3.

And then as we think about next year, certainly, we're going to work hard to try to take new stores aside. It's going to be our job to try to manage those costs. It's something in the low to mid-single digits at the highest for us to do what we want to do, which is drive earnings growth in the high single digits. So that's before share buybacks. So we're -- we've got work to do, but we're working on it, and we'll continue to work on it through the remainder of this year before next year ever get started.

Operator

The next question comes from Rupesh Parikh with Oppenheimer.

Erica A Eiler - *Oppenheimer & Co. Inc., Research Division - Equity Research Associate*

This is actually Erica Eiler on for Rupesh. So I wanted to touch on traffic as well. So I guess, first, just curious if you're seeing broad-based traffic improvements throughout the chain? Or if there are specific geographies of note? And then second, with gas prices easing here, just curious if you think that's helping the business at all here lately.

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

I would say on the -- this is Chip, on the gas prices, it's -- I think it's too early to tell. We're not seeing a direct impact. I do believe that gas prices, as they start to come down, that will help everyone like it should help everyone versus where we are, as it relates to the regions. It's interesting when you look at the regions. I think the areas where we have a ton of stores, and we've been there for a long time, we had -- in Q2, we had solid results kind of in line with the company.

I think when you look at the emerging markets, we really are doubling down in Florida, Mid-Atlantic, we had above average as you would expect performance because they're newer stores and they're ramping in general. The areas where we're a little bit weak is the areas where we've been there for a while, and we don't have a lot of stores. So we really don't have a brand presence. We don't have a lot of stores. The Northwest, where we haven't been doubling down, places in like Alabama or Louisiana. Those areas where we just don't have enough brand awareness, and we haven't committed to building more brand awareness there.

Erica A Eiler - *Oppenheimer & Co. Inc., Research Division - Equity Research Associate*

Okay. That's helpful. And then just on the decline in units per basket, so you talked about that getting slightly better sequentially. Are there any efforts that you can highlight for us where you feel like you're really starting to see traction as it pertains to driving those increased units?

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

Well, the only thing I'd repeat, Erica, is what I said a little bit earlier, I think our deli business, we're seeing a strength in that as it comes through. Our bakery business, we've been encouraged by some of the work that's coming through on that. And our underlying dairy business has been pretty strong relative to that. But it's within the context of an industry that's seeing a reduction in units per basket. And we talked about it in the last quarter, we're just looking to try and get 1 or 2 units extra in the basket. And the places that we're seeing the biggest traction is probably our deli business.

Operator

Our next question comes from Krisztina Katai with Deutsche Bank.

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

I guess I wanted to follow up to some of the store dynamics that you have highlighted. Last quarter, you talked about softer performance in fresh. I think today, you said frozen dairy are better, you're seeing good traction in deli. So maybe if you could just talk about how the various departments are performing now that traffic has started to come back. And then how are you planning on capitalizing on this to essentially ensure that you will continue to see traffic improvement?

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

So from a category point of view, again, we've been a little bit encouraged by our fresh business of late. Our produce business has picked up a little bit, which we're encouraged by, given it's so important to our business. We had a strong run in our vitamins and HABA department given what happened at the start of Q2, so there's some encouragement there. How that will play out, I'm not quite so sure.

Going forward in our deli business, I'll reiterate we're doing well there. And across -- the deli and frozen's being driven by better in-stock. And it gives us some encouragement that when we get that PICA implementation across the other categories, we'll see a more even split, an even spread of the improvements from in-stock. So the categories have done well, as you said, frozen dairy and deli. Produce is picking up a little bit. Vitamins did well. I'm not so sure how that's going to play out going forward.

And across the board, we've got a very unique -- one of the things that's kind of switched is our bulk business. When our -- bulk was hammered through COVID. And we had to close a lot of them down. And some jurisdictions didn't even let us sell them, and we had to buy up all the bulk. We're seeing some encouragement in that, which is -- given the strength -- what that does for a consumer, it allows the portion control, allows them to manage value a little bit. So we think we've got a positive differentiation in that space. I'm kind of hopeful that, that will help drive some business going into Q3 and Q4. I think we'll see some positives there as that starts to reopen and people get more familiar with it.

So -- I mean that gives you a kind of flavor of where we are across the category. We continue to work on marketing initiatives to make sure we keep the momentum that we've seen in the last 3 quarters on traffic moving forward. And traffic remains a little bit positive for us, which is important to us going forward.

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

Got it. And as a follow-up, just -- as we think about inflation, I mean, we heard from Costco tonight that July inflation was similar to June, but we also have a pretty severe drop. Is this something that is giving you concern from a sourcing perspective, considering that you also work with smaller farmers who might be more challenged with the cost of running their businesses right now than some of the bigger food manufacturers.

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

It doesn't particularly concern us more than the general concern about what the pressures are on the economy going forward. We're certainly working closely with our produce growers, and we give long-term commitments to those guys. So I'm -- and we're passing on -- we're taking cost increases and passing those cost increases through, which should give us some confidence that we can supply -- we can source what we need to supply. So it's not something that's bothering us too much just at the moment. We're in pretty good shape. There's 1 or 2 categories in the more commoditized space where we're competing with other people that we're seeing some challenges but not so much in our produce space.

Operator

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

Kendall Belinda Toscano - *BofA Securities, Research Division - Research Analyst*

This is Kendall Toscano on for Robby. I just wanted to see if you had any update on how you're thinking about inflation as we move through the year. I -- but you had said last quarter that the expectation was you would expect some of that to dissipate as we move maybe into the back half or through the year. Now that we are a little into the back half, I guess, have you been seeing anything in terms of products' cost increases that would lead you to believe we could start to see inflation moderate?

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

I haven't seen anything yet. There's a lot of volatility in the fresh produce space where it goes up and down and up and down, given the nature of supply in that space. You would have expected inflation maybe to come down given how much work the Fed have been doing on interest rates, but we haven't seen it. And we continue to see a level of inflation that's pretty unprecedented, and we're not expecting that to change anytime soon. But who knows?

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

We might get a little bit of relief on some of the cost side as oil prices come down, but not -- I don't think that's going to impact the product input costs in the near future.

Kendall Belinda Toscano - *BofA Securities, Research Division - Research Analyst*

Got it. That's helpful. And then my other question was just on the traffic trends. I know you said that there was a sequential improvement from the first to the second quarter. I was just curious if you could give any color on a 3-year basis, looking at a more normalized year just given last year, 2Q was an easier comparison than the first quarter was. I guess, yes, was there still a sequential improvement if you looked at traffic on a 3-year basis?

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

When we talked about sequential, first, we were talking about through the quarter, so from period to period. We don't give the actual numbers, and we don't do that for the quarter. And then we don't -- at this point, looking at 3 years for us is we just don't look at the 3 years anymore. We feel like we're in a really stable place where from this point going forward and our guidance sort of implies that it's really pretty stable right now year-over-year as it relates to traffic.

Operator

Our next question comes from Mark Carden with UBS.

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

So to start another question on unit growth. What are the biggest factors driving the slower-than-expected expansion in 2023? Is it primarily supply chain-driven? Is it getting tougher to find locations you want to be in? Or real estate cost just higher than planned? Any extra color there would be great.

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

Sure, Mark. One of the things that we've talked about and why we've not opened as many stores in 2022 as we would have liked isn't that we haven't got the sites, it's the pace at which we can build the sites, partly the supply chain challenges. We've had some fairly significant supply chain challenges on little pieces of things that go towards air conditioning, little pieces of things that go towards refrigeration.

And the other thing that's kind of slowed us down in 2022 was the planning and getting the licenses from the various authorities who didn't have people in the office monitoring and planning it through. So the kind of constraints on licensing, on permits, the constraints on supply chain have led us to the number of 15 to 17 in 2022.

As we've said often, we're sitting on 80 to 85 -- I'm not sure of the exact number Chip has said. On 80 to 85 signed leases, so we've got them in place. So 2022, you could -- 2023, you could say, "Well, why are you not doing more than 30 then?" I think we're being naturally cautious given where we're at in the context of what's happening in supply chain. It seems to -- it's not getting hugely better, but it's definitely not getting any worse. So we're feeling confident on the 30 number for 2023. But as I look at the pipeline, we've got a bit to do for '24 to build the pipeline up, but I'm confident the sites are there. And certainly, as we look through the opportunities where there are locations that we can build stores that have our target customers, there's more than enough for us to do 10% new stores into -- back end of 2023 and into 2024, more than enough. The challenge has been execution and federal legitimate execution challenges that we faced. And so if that gives you a flavor for it, I'd like to think we maybe do a few more in 2023, but we're pretty -- we're sticking with 30 at the moment.

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

Got it. That's helpful. And then with inflation staying as high as it's been, are you seeing any changes in trade down? I know your private label isn't necessarily opening price point like this for others. Are you seeing movement in fresh categories or anywhere else?

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

We're seeing some trade down, as we've talked about in the last meeting. And the number of the sizing of avocados that people are buying, the sizing -- the number of grapes that they'll buy in -- at any one time, so people are moderating the number of cherries that they'll buy. We -- clearly, produce is a big part of our business. And people buying -- still buying a lot of produce from us, but the weight of what they're buying is probably going down a little bit going forward.

We're seeing a little bit of a trade down in areas like our health and beauty business where people are trading down to cheaper products. It's not as big an issue for us. Again, I mentioned bulk because I think that might be one of the reasons that are kind of -- our bulk business picked up a little bit in the last 2 or 3 weeks. I think people are seeing the opportunity to buy the right amount -- the volume that they need, so they're able to trade down in size a little bit. And we're doing some work on some of our products to try and make sure that the sticker shock of the price point comes down because we changed the size on it. So if that gives you a flavor for it. We're working on it. We're watching it, and we are seeing a bit of trade down just like everyone else. It's just different in our business, Mark.

Operator

Our next question comes from Robert Moskow with Credit Suisse.

Robert Bain Moskow - Crédit Suisse AG, Research Division - Research Analyst

In the last earnings call, you talked about a downturn in traffic at the very end of the quarter. If you had to just kind of like summarize like what went right to turn that around, was it execution? Or do you think there was other macro factors that help things get better?

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

Macro factors, I think there may have been some macro factors as people went away and then -- and came back. I think there might have been some in the middle of that lot as we -- as you retrospectively look back at things, there might have been some things. But the thing that we focus on and we talked about is we control what we can control, and we think we've done some things to help drive our business a little bit as we go through Q2, as I outlined earlier, in stock, working harder, being better in stock, store competitions where the teams are competing each other to sell more units in the basket, putting in daily equipment, putting in new cabinets, putting in new areas for us to sell meat products, the seafood road shows. So there's a number of things that we can point to that we did that we think can improve that units per basket.

The traffic side of it, I think there's some macro factors in that, and some of it's about -- I think, some of the tactics that we used in marketing, as we try and think through what are the right tactics to use in marketing? How do we do it better? How do we learn from it? And certainly, that's something that we continue to work at. And I think we're learning a little bit as we go on our marketing initiatives.

Robert Bain Moskow - *Crédit Suisse AG, Research Division - Research Analyst*

And how do you think of the macro environment just from here? Because I think the pushback on your stock is that people doubt whether consumers will go to a second grocery store for their weekly shop or a third grocery store like Sprouts, given gas prices are still high, maybe fading a little bit. Like do you think that it's getting easier for you? Or is it getting harder? Or how much of an uphill climb is it?

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

Well, I think -- to be honest, who knows what's going to happen in regards to uphill claims for everybody over the next 6 months or so. I think there's a lot of uncertainty in that for all of us. I actually think that uphill climb for us is less of an uphill climb for others. If you're a vegan, you don't all of a sudden not become a -- change your dietary habits because of inflation or because of any kind of macro environment on gas pricing. And I think the fact that we've got differentiated assortment means if that's what you're worried about, that's what you'll go and shop at. You can't get a lot of the stuff that we sell in the traditional grocery. That's the reason we can coexist so effectively as a complementary retailer as opposed to that.

So the question which you raised is will they go to a second store. They'll only go to a second store if there's something in that second store that they can't get in the first store, and I fundamentally believe that's why our differentiation is so important to us. And it's very clear that the customers that do shop with us because of keto or paleo or plant-based or vegan or vegetarian or flexitarian, the reason that they do it is because they can't get it anywhere else because they're going to take the big guys for Tide and Coca-Cola, and they can't get that from us. So yes, it's -- I think there's some macro challenges for everyone in the course of the next 6 or 9 months or so as this economy works itself out. But we're confident that the differentiation that we have drives the proposition so that -- as I say, people have got to eat. And if you're conscious of what you eat, you probably have to come to Sprouts.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Jack Sinclair for any closing remarks.

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

Well, thanks very much for your attention and listening to us. We really appreciate your interest in our business, and we look forward to further updates as we go through the year. Thanks ever so much. Take care.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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