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SFM - Q1 2016 Sprouts Farmers Market Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Sprouts Farmers Market first-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, today's conference is being recorded. I would now like to introduce your host for today's conference call. Ms. Susannah Livingston, you may begin.

Susannah Livingston - ***Sprouts Farmers Market Inc - IR***

Thank you, and good morning, everyone. We are pleased you have taken the time to join Sprouts on our first-quarter 2016 earnings call. Amin Maredia, Chief Executive Officer; Brad Lukow, Chief Financial Officer; and Jim Nielsen, President and Chief Operating Officer, are also on the call with me today.

Sprouts' 10-Q, the earnings release announcing our first-quarter 2016 results, and the webcast of this call can be accessed through the Investor Relations section of our website at sprouts.com. During this call, Management may make certain forward-looking statements, including statements regarding our future performance and growth, product expansion, new store openings, and 2016 expectations and guidance. These statements involve a number of risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. For more information, please refer to the risk factors discussed in our filings with the Securities and Exchange Commission, along with the commentary on forward-looking statements at the end of our earnings release issued today.

In addition, our remarks today include references to non-GAAP measures. For a reconciliation of our non-GAAP measures to the GAAP figures, please see the tables in our earnings release. For 2015 we have presented adjusted income, adjusted earnings per share, and adjusted EBITDA, with adjusted measures stated in the reconciliation tables in our earnings release. For the first quarter of 2016, such adjustments would be immaterial. As such, we have presented net income, earnings per share, and EBITDA without adjustments.

For the first quarter ended April 3, 2016, we reported diluted earnings per share of $0.30. Diluted earnings per share increased 20% from adjusted diluted earnings per share of $0.25 in the same period in 2015. With that, let me hand it over to Amin.

Amin Maredia - ***Sprouts Farmers Market Inc - CEO***

Thank you, Susannah. Good morning everyone and thanks for joining us today.

We are pleased to report solid top-line sales growth and bottom-line results for the quarter as we continue to expand across the country engaging with both our existing and new customers. For the quarter, net sales grew to $993 million, up 16% compared to the same period in 2015. Comparable same-store sales for the quarter was 4.8%, within our guidance of 4.5% to 6%. Our merchandising and operations teams continue to drive sales and comps across the store. We were very pleased by the great comps in our non-perishable departments, which were offset by the significant deflation in proteins and adverse weather conditions in certain states in the back half of the quarter. Excluding the impact of deflation and temporary weather impact, our business remains healthy and we remain excited by the momentum we are building in our strategic initiatives, which I will cover later.

During the quarter we saw growth in both traffic and ticket, with a 50/50 split for the quarter. To briefly expand on deflation, the low inflationary environment experienced last year continued in Q1, resulting in a 0.5% inflation in the first quarter, lower than our original expectation of 1% to 2%. This was mainly driven by the quick leveling out of produce inflation towards the back half of the quarter, in combination with the continued deflation in the protein category. We expect a near-zero inflation to continue at least through the second quarter.

On the new store front, we added 11 new stores in the first quarter and three more to date this quarter for a total current store count of 231 stores. Our pipeline remains strong, with 53 approved sites and 43 signed leases for the coming years. New store productivity continues to perform well, in the 75% to 80% range. We remain confident in our ability to secure great locations as we expand over the coming years.

Let me shift and provide a quick update on our 2016 priorities, focused on driving sales growth, investment in infrastructure, and investments in our teams. Let me start with sales growth. We have already started to implement our expanded deli offering in our existing sites as well as many new stores. To date this year, 24 more stores, which includes 12 existing stores and 12 new stores, include components such as prepared salad offerings, customer-facing sandwich stations, prepared food service cases, fresh juices, and specialty coffee. We are on track to achieve our goal of rolling out this initiative to 30-plus existing stores this year, and approximately 70% of our new stores. Our whole meal replacement offering area includes even better ingredients standards, more variety, and improved packaging. These enhancements are being received well by our customers and add to our breadth of healthy products selection at Sprouts.

Our private level brand continues to grow and once again has outpaced our Company average in both sales growth and comps. Private label currently represents nearly 10% of our sales and we expect it to continue to grow and outpace Company sales and comp growth. By year end we plan to surpass the 2,000 item mark in our private label brand program.

The second focus is our investment in infrastructure. We are excited to build on our authentic in-store customer engagement to out-of-store engagement through the expansion of our digital offerings. In April we launched Sprouts' mobile coupons to customers. Through our improved Sprouts app, customers can now clip mobile coupons that will be applied through an easy scan of a barcode on their smart phone at their next checkout. We are already receiving great feedback from customers, who love the ease of the app, allowing them to make their grocery list, get their coupons, and scan at the register, all at the touch of their phone. We also expanded our partnership with Amazon Prime Now home delivery to the San Jose area, bringing the total up to five stores in three markets. We continue to join our customers on their healthy living journey both inside and outside our store. And you'll hear even more about our customer connections as these implementations take place.

The third and final area is our continued investment in our team members. We have been extremely pleased with the feedback we are hearing from our team members in regards to our in-depth training program. Our expanded 2016 training program is in full flight. It includes a comprehensive training program focused on functional product knowledge, as well as training and developing future leaders to help our team members maximize their potential for new and growing responsibilities given our significant expansion plans in the coming years.

In summary, our business fundamentals remain strong and our current strategic initiatives are on track. Our team remains focused on delivering a differentiated shopping experience through continued better-for-you product innovation across all categories in the store, great in-store customer engagement, and increasing customer engagement outside the store through our digital platform strategies.

With that let me turn the call over to Brad to speak about our financial results and guidance.

Brad Lukow - ***Sprouts Farmers Market Inc - CFO***

Thank you, Amin. First I have to say how excited I am to be joining such a strong team and a great brand at Sprouts. I look forward to meeting many of our investors on the road in the months to come.

As for the first quarter, let me spend a few minutes discussing some of the business drivers and guidance for the remainder of the year. As Amin stated, we are pleased with our top- and bottom-line results for the first quarter of 2016, and are pleased with our comps of 4.8% considering inflation of only about 0.5%. As well, the first quarter diluted earnings per share increase of 20% is reflective of the strong business model and our ability to remain value-oriented to our customer while responding to market conditions.

For the first quarter, gross profit increased by 19% to $307 million and our gross margin rate improved 80 basis points to 30.9% compared to the same period in 2015. This leverage was primarily due to deflation in certain categories, driving higher margins; and more normalized promotions compared to the prior year. Direct store expense was $194 million for the quarter, and as a percentage of sales was 19.5%, an increase of 50 basis points compared to the same period in 2015. This was primarily due to higher payroll expense from planned wage increases, partially offset by less holiday pay from the timing of New Year's Day 2016, which landed in the fourth quarter of last year. In addition, as mentioned by Amin, we have increased our training costs as we continue to invest in our team members in 2016.

SG&A totaled $31 million for the quarter, and as a percentage of sales was 3.1%, an increase of 30 basis points compared to the same period last year. This was primarily due to higher stock-based compensation expense due to executive changes made in the third quarter of 2015, and higher corporate overhead as we continue to build the foundation to support our growth by building out infrastructure and technology, including the business intelligence function and human resource systems.

EBITDA for the first quarter totaled $97 million. This was an improvement of 15% when compared to adjusted EBITDA in the same period of 2015. EBITDA margin came in at 9.8%, equal to the first quarter of last year. Net income for the first quarter totaled $46.2 million, an increase of 20% from adjusted net income in the same period last year. These results were driven by top-line sales and margin improvement in addition to lower interest expense as a result of last year's voluntary paydown on our revolver, a decrease in the interest rate from our April 2015 refinancing, as well as a slightly lower effective tax rate.

Shifting to the balance sheet and liquidity, our balance sheet remains strong as we continue to generate solid operating cash flows. For the quarter, we generated $98 million of cash from operations and invested $32 million in capital expenditures net of landlord reimbursement, primarily for new stores. During the first quarter, we repurchased $59 million, or approximately 2.4 million shares, of common stock under our $150 million share repurchase authorization. We ended the quarter with $146 million in cash and cash equivalents. With our strong operating cash flows and low debt levels, we are well-positioned to self fund our growth plan and build upon our strong liquidity position.

Let me now turn to 2016 guidance. Due to the lower inflationary environment and shift in timing of some of our 2016 new store openings, we are adjusting our sales guidance for the year to the following: net sales growth of 15% to 17%; and on a comparable 52-week basis, this would equate to net sales growth of 17% to 19% from the previous 52-week basis range of 18% to 21%. All other guidance remains intact from our last call, which includes: comp store sales growth in the range of 4% to 6% for the year. And we remain on track to open 36 new stores. Adjusted EBITDA growth of 9% to 11% on a comparable 52-week basis, and this equates to 12% to 14%. Adjusted diluted earnings per share of $0.96 to $0.98, which equates to a 14% to 17% growth on a 52-week basis. And CapEx, net of landlord reimbursements, in the range of $145 million to $155 million.

A few additional items to note on our 2016 guidance. First, we expect inflation for the year to now be in the 0% to 1% range, as we expect to see continued protein deflation through midsummer, as well as limited inflation in produce in the near term. Second, the timing adjustment in some of our new store openings is mainly attributed to inclement weather. Third, as it relates to margins, as we have done in the past we will continue to make price investments as necessary to drive traffic and top-line sales and to maintain our competitive position. We do not expect the level of gross margin improvement experienced in the first quarter to be sustained. Fourth, on the direct store expense line, our investments in our team members through training and strategic wage increases will continue to delever DSE as a percentage of sales throughout the year compared to 2015.

We continue to believe that these strategic investments are important to build a strong pipeline of future leaders, given our unit growth across the country. And below the EBIT line we expect to have approximately $15 million in interest expense, including capital leases and other interest expense, a weighted average diluted share count of approximately 154 million shares for the year, and a corporate tax rate of roughly 38%. Lastly, for the second quarter of 2016 we expect comp store sales growth to be in the range of 4% to 5%, which reflects our expectation that low levels of inflation will at least remain until midsummer. And as a reminder, in the second quarter of last year we reported an improvement of 50 basis points on the SG&A line, primarily driven by lower bonus expense, which we will be cycling this second quarter.

In conclusion, we are pleased with our financial and operating performance in the first quarter. We remain focused on driving top-line sales growth. And while the inflationary environment has impacted our sales, we feel confident about our business model, our solid balance sheet, and our strategic investments and growth plans to position Sprouts to be relevant with our customers today and into the future.

With that we would like to open up the call for questions. Operator?