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PRESENTATION

Robert William Summers - *Macquarie Research - Analyst*

So thanks for coming. We have a list of questions. I guess today, we're not dealing with the fact that you're going to be bought by Albertsons unlike last year. So what I'd like to do is just take the conversation through some macro talking points and then dig into a little -- just specific about you guys.

QUESTIONS AND ANSWERS

Robert William Summers - *Macquarie Research - Analyst*

And I guess, point one would just be characterize the overall competitive environment. And I think what would be helpful is to go back to 2 years ago when you had sort of hypercompetitive conditions that created some challenges, use that as a reference mark and then talk about where we are now and what happens next.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. I think, in short, as most of you in this room know that in 2016, we were in a period where we had the deepest and longest deflationary period since 1960. And so that persisted through most of '16 and into early '17. And even as we came out of deflation early on in '17, we saw retailers were quite careful in increasing price, as we started to see inflation kick back in. And where we sit today, over the last 6 months, is, is we're seeing, at the shelf, companies continuing to increase price. As we're seeing today, it's modest, flat to slight inflation. So at the shelf, we're seeing price increases, however, in promotion and ad, people are still quite very aggressive. So it remains pretty competitive in promotion on the promotional side as we sit here today.

Robert William Summers - *Macquarie Research - Analyst*

So I guess related to that, just as you think about inflation now, you've had -- and I know this is challenging when you look at sort of the PPI and CPI numbers, the pass-through rate has been a little challenged in aggregate. Can you maybe talk about that and how the current pass-through compares to what we've seen historically? And what's that -- what makes that better or worse, particularly considering that if you look at the February data, we're starting to roll over? And if PPI stays at this index level, we'll be deflationary next month. So maybe just -- and I know that you have like a different basket and different mix...

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Different mix, yes.

Robert William Summers - *Macquarie Research - Analyst*

And so that creates some challenges, but just talk about that in general because I think that, that will drive sentiment for the space.

Bradley S. Lukow - *Sprouts Farmers Market, Inc. - CFO, Principal Accounting Officer & Treasurer*

Sure. Yes, so again, our expectation for the full year is flat to just slightly inflationary. And the CPI data that came out suggesting some categories, like poultry and fruits and vegetables, slightly inflationary, being offset by some deflation in the dairy category. When you think about our mix of product that we sell, it's quite a bit different than the CPI baskets. So you have to take that into consideration. What we've seen in produce, which is almost 25% of our business as we talked about on our Q4 earnings call, we've seen some tightness in produce in the -- in January, February in terms of product availability from -- due to weather and some port issues. So for us, it's an important traffic driver in terms of having produce as a lead to drive traffic into the store. And what we've seen is a little bit further extension of having some tightness in produce in the first quarter, but we see we're exiting that now at the end of the first quarter. And to Amin's point, we are seeing, in general, a slightly inflationary categories where, on shelf pricing is being taken up. It's not the deep promotional environment that we saw back in December of 2016. Still promotional, still tight, particularly in proteins. We're seeing a little bit of an uptick in promotional activity, but we're feeling good about the overall health of the business.

Robert William Summers - *Macquarie Research - Analyst*

And I know I was supposed to get to this later, but now is a good point. And I've made this mistake before when looking at inflation in fruits and vegetables, and they're sort of inflation that's driven by the fact that you don't have enough product, which is actually inherently bad. And then I guess within that, what's the right way for an investor to think about, okay, 1% to 2% is good or understanding the availability behind it because that's how you promote and drive traffic. What's a good just, again, reference point to think about the whole architecture of good inflation, bad inflation? Where is the over, under?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. I'll make 2 points here. One is over the last 3, 4 years, we've continued to broaden out our business to be -- we're still a produce-led business, but we try to be less produce-dependent business. And I think we've done a great job by expanding our categories and what we're doing in attribute-based work in our nonperishable departments, like grocery and frozen, the work that we're doing in private label, the work that we're doing in deli and meat and seafood, we can talk about later. So we're continuing to evolve the business and build, I call it, more motes in the business. In terms of traffic driving and produce from a inflation/deflation perspective, the ideal world is somewhere near 0, right, plus or minus. 0% to 2% inflation in produce is probably the ideal scenario for we're there all the time or if you're deflationary, slightly deflationary. And the reason for that is whenever you have significant inflation on items or categories in produce, it's just generally driven by a macro event or a big event -- bigger event, like weather or port challenges or distribution challenges. And that's just -- especially if it's weather, then the quality of the product is just not good. If it's weather, it's a lot of white shoulders on strawberries, the bananas aren't the right quality. So that's hurts our -- we don't like to promote things that aren't in great condition, and things are highly deflationary depending on what it's caused by. Sometimes, it's obviously not good to sales overall, but sometimes, a product can still be very good when it's highly deflationary. So somewhere around 0 is nirvana for us.

Robert William Summers - *Macquarie Research - Analyst*

Okay. Then another macro concern or sort of broader concern in retail is just can you talk about freight and transportation? I mean, it's been something that a lot of people have complained about. I don't think you guys have. So how are you managing it? And it seems like you're doing it better than others.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. I think 2 things there is this -- most of you know the issue is the logging device mandate. It's creating some shortages in the industry on trucking. So for us, on our soft distribution side, our team has always done a fantastic job on making sure that we were right in the guardrails of the law, of making sure that we were logging devices. So on the soft distribution side, we've not seen any impact. We don't have any impact from there. On the third party distribution, some of our bigger distribution partners, we're also -- had good processes. And so overall, we'll see for the next 6 months, probably a slight uptick. But in the bigger context as a percentage of sales, our impact to the bottom line, it's -- we don't expect it to be material to the company and, too, we've also built it into a guidance on expectation of what we could see any impact that we would have over the next 3, 6 months, 9 months.

Robert William Summers - *Macquarie Research - Analyst*

And then I guess, just moving on to the tax, right. So I think that, that discussion has evolved pretty significantly over the last couple of weeks based on the commentary from a lot of different retailers. You guys have already outlined your sort of intention in terms of how you separated it. And so I guess, one, just remind everybody what that is. And then, I guess, backing that up, now, do you think that there's a risk that you have to go further on the investment side? Because it seems that you have some retailers out there that may go deeper than everybody thought. Just maybe think about or just what do you -- how are you going to think about that and whether it actually makes sense to raise to the bottom as it were just -- like conceptually, how do you contend with it.

Bradley S. Lukow - *Sprouts Farmers Market, Inc. - CFO, Principal Accounting Officer & Treasurer*

All right. So just to remind everyone, pretty significant benefit to Sprouts with regards to tax reform, as we're a full domestic payer, annual benefit about $30 million. As we pointed out on our call, we've made a decision to reinvest about 1/3 or $10 million back into the business in the context of strategic investments on team member wages, health benefits as well as maternity benefits and others. And we really stepped back and looked at it from a competitive landscape point-of-view when we're growing as much as we are. We're really competing for the best talent out there, so we wanted to make the decision to reinvest in our team members to make sure that we are very, very competitive. We've seen a significant benefit. We looked back over the last few years on all the investments that we've made in our team members, in training, in wages, in development, manifesting itself into much better results on customer satisfaction in stores. So we think it's absolutely the right decision to make. Further, we're really getting ahead of additional minimum wage pressures that are coming in 2019 and '20. So this is really a proactive approach to make this investment that's going to keep coming in any event. The other thing I could say with regards to this, most companies have come out and made statements around reinvesting in wages for the most part, not a lot of talk about reinvestment in price. I think people are being very guarded about that. But when companies talk about potentially some additional investments in the customer, it doesn't necessarily mean price. It could be investments in click and collect, online. But we've stepped back, and we have a very robust process around competitive pricing and maintaining our significant advantage, particularly in produce, looking market-by-market. And in the context of our 2018 guidance, we have taken into consideration that there may be some additional pressures coming out of tax reform, and we'll be there to be able to make sure that we maintain our position, and that's reflected in our guidance.

Robert William Summers - *Macquarie Research - Analyst*

Good. And then just on a broader basis, just thinking about that you brought up online, digital. Just may be outline for us how you're thinking about it. I think it's really interesting to watch the space evolve. And I think that it's becoming apparent that you need to have stores, that even if you don't have a quality halo around your brand, the (inaudible). So this intersection of physical and digital, it's continuing to evolve. I think that you are -- you have a variety of relationships out there that are evolving. Maybe talk about what -- how that changes going forward. How you maybe leverage off of Instacart? And when you think about delivery or the service fees associated with that, what's the long-term algorithm there? And when do you have to maybe do something on your own? And within that, I think what's interesting with you guys in terms of experience, in terms of expanding [of ideas] and how that actually impacts returns and maybe the thought process on what [it involves].

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, sure. I spent some time in the last 4 years in -- at shop talk, and it's quite interesting to hear a lot of talk, right. So I think in terms of e-commerce and grocery, I really have to separate it into 2 buckets. If someone -- whoever is on the line, can you please mute your phone? Please mute your phone, thank you.

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

Or if the operator could please just put everyone else on mute but the speakers, that would be great.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

So let me continue. It's disruptive for me at least. Let's look past that. I think, really, from an e-commerce perspective in grocery, I have to bifurcate it in 2 buckets. I call it fresh and then consumables or dry goods. I think dry goods will continue to evolve at a pace, especially the bulk items, will continue to evolve at a pace where the customer wants it to evolve. We've seen on the fresh side -- you hit the nail on the head, Bob. I think the things that matter on the fresh side is the halo around the brand, the quality of the products, the quality and execution of what's happening is super important. And what we've done over the last couple of years is a few of those things that absolutely matter is how good is your brand, how trusted are your brand, how trusted are your deliveries. Not only on time because I think generally, everyone is doing a good job on on-time delivery. But what matters is how good is the quality of the product is. Well, first of all, do all 20 items that are ordered show up, okay. And second, what is the quality of the product that actually shows up. And brands who are rooted in quality, are going to win over time in the e-commerce space because they're in the best position to deliver quality and fresh product to the door. So we know today that e-commerce in grocery, somewhere between 2.5% to 3% and fresh is less than 10% of that. So fresh is very small today, but I think it'll continue to grow. But I don't think it'll grow at the breakneck speed that we've seen other retail grow for a number of reasons. We plan for -- thinking, hey, let's assume for now in the midterm, it's 10% of the business, and we plan for that and make sure we execute against that. And we feel very good in terms of having the capabilities around home delivery and if we need to add click and collect, being able to do that really well, of the key things that I talked about. So I think it'll – the other benefit that Sprouts has is because we've, in fact, learned over the last couple of years through multiple partnership is most of physical grocery is done within 7 -- physical grocery shopping is done within 7 minutes of the store. And what we've learned in home delivery and e-com is it's the -- and same-day delivery, it's the flat that we've seen in most of our -- so it's really been a good extension of our business. So for retailers like Sprouts and Costco and maybe even Trader Joe's, who have fewer stores and a separated network, it actually adds incremental sales. So it's a more -- it could be a flat to more profitable business. When I say flat, meaning same to EBIT margins or higher EBIT margins because of that incrementality, because you're leveraging your fixed cost. If you have a very mature system with stores elbows apart, it's a burden because you're getting no incrementality and the customers are not paying the full $10, $12 to pick, pack and ship. So it's an added burden and fee to the business. So we're -- we at Sprouts actually hope that the customer adoption in this space grows faster and faster because we have a natural leverage in the system from it.

Robert William Summers - *Macquarie Research - Analyst*

Okay. So right now, I mean, if I were to think about the next sort of talking point there, I mean, from a margin rate perspective, are you agnostic? And then clearly, you're articulating incremental gross profit dollars. You're -- up to what percentage of the business do we kind of stay under the halo, do you think?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

I won't speak to the specificity of how much more incremental it is and get into the details of that, but I think the key is this, for any retailer, including Sprouts, is what is the mix of incrementality versus cannibalization of that store look like. And if you have some level -- for different retailers, the line will be different. But if you don't have a certain amount, that certain level of percentage of that mix at home delivery that's incremental, it's going to compress our EBITDA by definition, not because of that extra cost that the customer today we don't see willing to pay the full $10, $12 for delivery.

Robert William Summers - *Macquarie Research - Analyst*

Okay. And then I guess, starting to drill down a little bit, just remind us again -- look, I think that you have a very uniquely positioned asset. I think that a lot of people at certain points don't really understand where you take market share from. Just can you walk through sort of who your shared donors are when you put a unit in, what's the overall go-to-market strategy pricing in Sprouts, just sort of the basics because I think that's lost over time and kind of you're put in 1 bucket when maybe you should be in a different one.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. I think that the broad frame is there's about 6,000 discounters in the country. That would include Walmart, all of these others. There's 28,000 traditional grocery stores, and there's 5 to -- 5,000 to 5,500 specialty stores like Sprouts, Trader Joe's. That even widens because of their differentiated business model in that bucket because they're just not a traditional grocery store, they do more than that. And I think from a differentiation perspective where if you look at natural and organic today, it's $100 billion business out of the $850 billion industry. If you include fresh natural organic, so you start including produce in that number in bulk, nuts, trail mixes, grains, it starts moving towards $200 billion. So it's a pretty sizable business in that sense. And with the customer today, the customer trends, clearly our customer, 20 years ago, was looking for pure convenience and price. It didn't matter if it was in a can or packaged or what the product ingredient sets were. Today, customers are looking for fresh food, healthy food, and those are one and the same but different. Health meaning what is the ingredient that look like, how clean is the product, where did it come from, where it was sourced. Fresh meaning yes, it's actually fresh and not packaged, right. They're also looking for convenience, how quickly can I make it and consume it and still starting from scratch. They're also looking for the right price, and by the way, they're also looking for in-store experience. And I think in-store experience is something that we're focused on at the company a lot. I take that back, it's experience in general, whether it's in-store or out of store. And out-of-store means what is that experience and interaction with the customer look like on the phone. Because more and more, the customers are interacting here on the phone to learn, educate themselves, make their shopping lists or get it home, delivered at home. Our tells, it's more and more starting here, but the experience is happening in the store. So when we think about Sprouts and how we're differentiated is given its small box, we're continuing to invest more and more in fresh. Today, over 60% of our business is fresh. We're a value retailer, we're a healthy retailer, over 90% of the products at our store are natural and organic, well over 90% today. It's a convenient, quick in and out. And with home delivery, it's even a better convenience of not -- and know-how with just at home, right. And experience as the last leg is we've always been fantastic at health and value, and we're really focused on customer experience in the store and out of the store over the next 2, 3 years to improve the overall business model. And so I think that's why we are differentiated compared to many of the conventional -- of the 28,000 conventional stores who are underinvested and not on trend and not as relevant today as they were maybe 10, 15, 20 years ago. There are some conventionals that are very good. And they are relevant, they're investing, they're putting money on CapEx, but it's about 20%, 25% of that 28,000.

Robert William Summers - *Macquarie Research - Analyst*

So you just pick up the phone -- just kind of walk us through where you are in the digital process? I mean, I think that there's a lot of things that you're putting on -- in the place that can create some leverage over time in terms of having data, promoting to the customer individually, building lists, things like that. And can you kind of walk us through where we are and where we're going?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. So back to the point is this we know as a retailer, we're fantastic at health and value. And what we want to do on our strategy in mobile is really, one, to -- and we see when we have -- our loyal customers are those who appreciate health and value. And so to extend that experience is we're really focused in our digital, besides home delivery, on our digital new platform that we just launched 6, 8 weeks ago on health education, health inspiration and convenience to make it easy when you find a gluten-free recipe or you find a vegan recipe or plant-based recipe. You look at it, you go, "This is fantastic. It looks great because I'm seeing what it looks like. Oh, here's the ingredients and how I make it." You can just tap it and add everything to your shopping basket, right. And our next phase is, "Oh, by the way, I can tap it again and get it delivered to the house." And so that's the kind of frictionless approach we're taking to really inspiring, educating and then making it more convenient. Sure, there's coupons and there are store locators on there. And all those things are basic table stakes, but we're really trying to elevate on the full shopping experience online if a customer decides not to come into the store. And a big move for us was this, having a full product catalog-priced store live on this was a pretty big -- it's a pretty deal going forward because the interaction becomes a lot better with the customer when you move down that path. So we've got some interesting things in the work to continue to build on health and inspiration and education that I won't talk about, but that'll roll out over the next 6, 12 months.

Robert William Summers - *Macquarie Research - Analyst*

Right. I mean, just out of curiosity, as you look at digital engagement, I mean, how do you track your progress? I mean, is that there's a penetration? Is it service scores? Or just like how do you know that you're on the right path?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. No. It's great. So one of the big shifts in our new platform that we landed is we can now see what customers are going in, what they're looking at, how much time are they spending there. And to the extent that they're also putting it into their basket and then using the coupons attached to it, we can start seeing -- we already have a good amount of data on our customers' dietary preferences and health preferences, but it starts deepening our knowledge about a particular customer's interests, when their spending time in XYZ parts of the app or the website. Most consumers are on the phone today versus on the web. But we can start seeing that actual customer preferences and against their purchase -- actual purchase habits as well as how they're behaving on the site. We can start personalizing. We've already launched the items for you, which is not guesswork, but actually known information of what the customers' buying and where they're spending a lot of time or their dietary preferences. So it allows us to engage with, we call it, affinity-group level engagement where somebody is either plant-based or vegan or gluten-free or has a heavy interest in vitamins, have a -- so it's really allows deeper and deeper engagement with the customer. And our strategy in-store and out of store is always going to be is this we don't want to be the forceful seller. We'll really want to invest in the long term and inspire people and educate the people to eat healthier and then let them make their own decisions. That's what makes Sprouts successful, and that will be no difference. So we're not going to try to push loyalty programs, which are buy more, buy more, buy more. It's really about inspiring people and letting them make their own decisions.

Robert William Summers - *Macquarie Research - Analyst*

Okay. Just back to the delivery piece. I mean, I think that you guys have a building relationship with Instacart. Just remind us again, the penetration that you'll have by the end of the year because I think that you have...

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, that's a good question. Yes, we're -- we started with a soft launch in a few of our markets. We're continuing to deepen our launches, so we're rolled out in parts of California now, in Arizona, in Phoenix, our home city, parts of Texas, and we'll continue to move to other states. The hope is by the end of the year, we'll be in all of our major markets and probably secondary markets. And as we get good execution, which is critical to us, speed's equally important but less important than quality of execution. So as we see great execution and great customer service scores and great, not only on-time delivery, but items delivered and is the quality, freshness, overall scores high, then we're starting to continue to drive further marketing around it as cities and states are ready. So we're taking a very methodical approach of making sure that we have great execution before we push hard the marketing plan.

Robert William Summers - *Macquarie Research - Analyst*

Okay. Just taking a step back, I think that when you think about sourcing and infrastructure and your ability to source high-quality products better than conventionals. Can you just walk us through that? Because I think that there are people that kind of look at your size and say, "Okay, why can these guys do it better than somebody else that's significantly larger?" And you do. So just maybe talk through that.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, I think there are 2 elements. First, in produce, most of our relationships today are directly with the growers. And so we actually touch, feel and understand the quality of the product coming out of the ground. We have a very robust QC. Most retailers, if it doesn't hit a QC spec, we'll ask for a discount on the product, we send it back. It's not moving forward, it's gone. It's going backwards, right. So guess who gets the average or poor products around Sprouts because they know it's coming back. So I think we're doing some good things for the customer on that front. In terms of other areas of our business, it really gets back to product innovation and being -- using a combination of not only our big, large partners but also spending a lot of time and energy on new and small and innovative companies and taking risks. And then also, our private label strategy. So it's really being differentiated and rooting our business on health, value, attribute-based, like plant-based, raw [free] and et cetera. And taste, taste is a big buzz word inside the building because for the last 2 years, we've been really pushing on getting the taste level up. If you worked at Expo West, I always say is this people are always talking to me about all the attributes in a product, and I'm like, "Eh, didn't taste that great," right. So I think taste is a big deal for us. So we know we can influence our private label strategy the most because we can direct it, the taste profile of the items that are private label. But I think it's important -- it's becoming more and more important as we are working with all of our partners that, that's a big important element at Sprouts.

Robert William Summers - *Macquarie Research - Analyst*

So I guess, like leveraging off of that, I -- 2 things: one, just remind us again of some of the in-store initiatives that you have to drive sales, whether it's the deli, the butcher shop, what have you? And then kind of back to private label, where are you guys in terms of penetration? Where do you want to go? How constructive is that to the overall gross margin mix?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, let me touch on deli and meat and seafood, and then I'll let Brad talk about private label. And what we're doing there is this as far as -- if you think about our business and it's grown is, is we've been leaders and very authentic in produce, in bulk department, in our grocery, frozen, leading with natural organic products. In that -- in those departments, 90% -- I always 99% because they should be 100%, but in case something leaks in. 99% of the items in there are natural organic products in those departments. And so over the last 2, 3 years, we've spent a lot of -- as we saw the fresh trend continue to accelerate, spending more and more time on developing relevant, healthy, easy to heat or cook -- we call it internally ready-to-eat, ready-to-heat, ready-to-cook products for the customer. And as we've developed some great products, great packaging, put private-label branding of the Sprouts Market Corner Deli, The Fish Market at Sprouts, The Butcher Shop at Sprouts, as we've put those branding on it, now we're really focused on the experience and trying to redefine. And we've stepped back and looked at, now, we've added all these products, how do we merchandise them to the customer. And some of this innovation may apply to go-forward stores only and not as much backwards into the store in terms of how you merchandise it, rethinking that. We're pretty excited about how we can really start differentiating the experience because we're in the early innings of our store growth. So we can really look forward and keep innovating in new stores on the flow-form function, customer experience in those 2 areas. And so we're excited about continuing to grow that business because we see the fresh trend continuing for the next 5, 10 years. So I'd say that Sprouts today is not a natural organic healthy grocery store. It's a fresh natural organic healthy grocery store because that fresh element's becoming bigger and bigger for us, which is where the conventional -- the average conventional is not spending a lot of time. So we're pretty excited about that. And I'll let Brad add to what we're doing on the private-label side.

Bradley S. Lukow - *Sprouts Farmers Market, Inc. - CFO, Principal Accounting Officer & Treasurer*

Yes. From a private-label point of view, it's been a very important strategic element of our business model in driving customer loyalty and basket growth into the store. I think importantly, Sprouts is differentiated in terms of our go-to-market strategy on private label. It's not a customary national brand knockoff or inferior quality or lower price, it's really all about the taste, the ingredients, the attributes, unique packaging. You can only get it at Sprouts. And we've seen we're at 12% penetration of sales now. And when you consider that produce represents about 1/4 of our business, and there's very little private label on the produce side, we're much higher penetrated from an overall point of view than the headline number. We now have over 2,300 SKUs. We're growing private-label sales materially higher than the overall sales growth of the company, and will continue to drive penetration probably into the mid-teens. And you see some of the products before you, again, it's a very much differentiated strategy. Our customers love the product. And importantly, we look at the data. The average basket of -- that includes a private-label item is like 50% higher than the overall basket at the stores. So it's a pretty important driver. We've expanded the team, the reach. We're looking now into Europe. We're bringing international, from a frozen point of view, international entrées in, organic gelatos, a lot of unique products that you can't find in our competitors.

Robert William Summers - *Macquarie Research - Analyst*

Is it hard to find manufacturers of produce at this point? I mean, I know that you have 2 hard discounters that are coming into the market. I think that when you have sort of existing strategies from a lot of incumbent conventional retailers. So I'm kind of curious that how easy is it to find guys that manufacture your products at this point?

Bradley S. Lukow - *Sprouts Farmers Market, Inc. - CFO, Principal Accounting Officer & Treasurer*

Yes, we have a broad number of manufacturing partners that like to work with Sprouts. Because when you look at the size of the business now, it's sufficiently large from a scale point of view that the manufacturers get the production efficiencies on the individual runs of our products. So the team has actually done a great job in expanding the relationships with manufacturers. And we're working on product development together. So it's been a great experience.

Robert William Summers - *Macquarie Research - Analyst*

Okay. Just on a broader basis, thinking about -- look, I think that you guys take advantage of a flaw in the conventional pricing architecture where they subsidize center of the store pricing with the perimeter. One of the things that comes up in a lot of discussions is what happens if XYZ company or large national competitors says, okay, we're just going to have that in perishables and we're going to collapse our margin and see what happens. I think there's a lot of reasons that, that won't, but I just would like to hear sort of when you think about sort of the competitive advantage or the sustainable price gaps and what have you, how do you think about that?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, it's hard to, for me, to comment on or put myself in the shoes of products we don't sell, right. But making a structural change in the business for the conventionals, we always say we don't have a center store because we don't sell any of the 50% of their sales, CPG sales that they have. So I think the challenge there is this, that the huge amount of dollars, rebate dollars that conventionals get in center store make it very -- it's a very difficult situation to try to fundamentally and structurally change the nature of the business. It would be a pretty big -- it would be not only big, but long term, it would take a long time and be a massive disruptor, frankly, of the sales for a long period of time. I think to invest in -- and so to invest -- and you've got to make money somewhere, right. It's already a 3% EBIT business for the conventional grocers, 3% to 4%, somewhere in that range. And so structurally, you've got to make money somewhere in the store, and you don't see the margins expanding in center store anytime soon, I would imagine. And therefore, trying to make big shifts on the perimeter, it's not only hard in just on the pressure puts on the P&L, but it's also -- it's even much harder in execution. Because the perimeter, in terms of production, efficiency, muscle memory around having the right product set, frankly, is the starting point. So it's much more difficult to convert. And -- because we know this, because we've been through this over the last 5, 7, 8 years, much more difficult to convert the perimeter and just dropping prices. You are not going to get the dollars back, you just not.

Robert William Summers - *Macquarie Research - Analyst*

All right, got it. Okay. And then I think it's been a while since -- let's talk about the white space opportunity. I think that there is a lot of euphoria in the space in general when you had -- there was a set of companies that went public. And we had this sort of unique opportunity. Some things have happened since. So just where are we in that? And then within that, maybe talk about your expanding more on the East Coast. When the brand travels, what are you finding works? How -- what does it take to educate people, whether it's sort of the obstacles, what's been better than you thought, what's been harder, things like that?

Bradley S. Lukow - *Sprouts Farmers Market, Inc. - CFO, Principal Accounting Officer & Treasurer*

Yes. So it's still early days in terms of rolling out the format across many more states that we have in our sites. We are opening about 30 stores a year. I would say that if you look back over the last 2 years, 2016 and '17, we saw a really terrific new store productivity. We've gotten a lot better on site selection from a data analytics perspective and pinpointing the location of our core customer set, which has resulted in growth of average weekly sales in the new vintages. We're seeing that again in 2018, so we feel very strongly about the new store opportunity going forward. And recent markets that we've gone into in the Southeast, including Florida, have just confirmed to us that the brand travels extremely well. We are targeting a broad demographic of the U.S. population that is attracted to this model of value, of natural and organic and high-service, high-touch business model. And so we will continue to move into the mid-Atlantic, as we have pointed out on our Q4 call, in terms of new store openings. And we feel very excited about the long-term prospects. We've got many, many years of growth ahead of us, and we're really excited about the financial returns that are coming out of the new models.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Bob, I would just add to what Brad said is just from a macro perspective is just that we've been talking about this for a while that we'll continue to see consolidation in the conventional traditional grocery stores. And we're starting to see increased closures in that space also because of all the reasons we've talked about this morning. The interesting one has been is if you'd asked me 3 years ago, I would have said there's probably going to be a wave of consolidation in specialty also. And what's starting to happen is some of the specialties are just not going to make it, and no one wants to pick it up. And so you're starting to see more and more of that across the country, and I think that will continue. A few assets here or there might get picked up, but more of them probably don't get picked up, just something happens to them, right. So that one's been -- because it's a different world today, being differentiated and having relative scale, some level of scale is super important today. It's not as easy to start a start-up or a small company or even a midsized company today in specialty as it might have been 20, 30 years ago or even 10 years ago. So we feel pretty lucky in the sense that the scale that we have built in this space, which makes Sprouts pretty attractive.

Robert William Summers - *Macquarie Research - Analyst*

So I guess related -- what's the demographic look like at this point? I mean, I think that there was a big player on the market, they used to argue that education was the biggest sort of determinant in whether people shop at their store or not. When you look at your average customer and you look at sort of a range of variables, what do you see? And then I guess kind of related to that, when you go into a new market, maybe tactically walk us through print, radio, like how do you just let people know that you're there, other than just like popping up one day?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes. Demographically, we've always said that our data sort of confirms it is when we go into new markets we're – we want to stay a little bit right in the center, which we define center as this 40 to 80 percentile or 80-plus percentile of the median income and education -- and high education level on those markets. So it's a very broad demographic, right. It's more than half of any city. And then as we deepen the brand and as we continue, people start shopping in 2, 3, 4 years and sometimes in 5, 6, 7 years, I call it then we have the license to go at the edges deeper to the lower traffic and deeper into the higher demographic. Because the brand has deepened, strengthened, resonating. And frankly, some of our stores have done such high volumes, they need to get cannibalized. And so that's a great problem to have. So it's a very broad model, as Brad said earlier, is you're starting out on a new market, targeting 50%, 60% of the population of, for example, Baltimore or Philly. And so it's not a specialty niche concept that plays to the top 10%, 20% or the bottom, 10% to 20%, it's placed to a very broad demographic. And because of our differentiation and experience and quality and the uniqueness now of all the private label, the brand's starting to resonate very well much faster as a differentiated company. And more and more people have already heard about Sprouts when we walk into a new market, like Baltimore. It was shocking to us when we opened our first store a few weeks ago, how many people walked in and said, oh, I already knew Sprouts because I've been to my in-laws in Florida, or here in Dallas or in California or -- so they've been to a Sprouts before. So it's a pent-up demand. We're starting to -- I feel like we're starting to hit a tipping point as a brand, where more and more people already know us than don't know us. And our marketing team does a fantastic job of marketing and also our community service team of going into market, 6, 9 months ahead of time and really doing a lot of grassroots, digital engagement, in-ground engagement at 10Ks in marathons and other events in the community, working with local schools where we've set up a foundation program that builds community gardens at local schools to educate in lower-income areas of communities how to eat healthier. So we're taking a multipronged digital and underground approach, and our new plan of going into new markets has been fantastic and working really well.

Robert William Summers - *Macquarie Research - Analyst*

Okay. I mean, I guess related to that or just in general, I'll give you kind of a throw-away question but what -- like what has you most concerned? And then what do you think that -- what's the most misunderstood thing about your company?

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

I'll start in reverse order. I don't know if it's misunderstood, but I think that people probably -- many people will probably think of us still as a specialty concept. They probably don't fully understand that we're just a fresh, healthy grocery store and one that's really relevant to what the customer's looking today, from the millennial to the young family to the empty nesters to the older adults. And when we look at our data and our sales in heavy older adult population or heavy younger population, they're equally strong. So the relevance of the concept is perhaps one that I feel that at times is misunderstood. People might think of us as niche specialty or might go, "Oh, that's just more square footage coming to market." It's relevant square footage coming to the market, and therefore, those that aren't relevant are the ones that are suffering. And then in terms of what keeps us up at night is really accelerating even further of relevant and simplified experience for the customer. We've always been fantastic at product innovation. We've been fantastic around health, have been fantastic around value and now, we're putting up the next sort of pillar, which is what the customers are looking for is make it more experiential for me when I walk in, make it simple. Don't over clutter, don't over complicate what I need to do. And that's why when we're sitting in a meeting and somebody said, "Yes, it's kind of like ready-to-eat, ready to heat, ready to cook." And we literally said, "Okay, the first 300 square feet on the right-hand side of the store when you walk in, it'd only be ready-to-eat. The wall can only be ready-to-heat and then past that, it's ready-to-cook." Right? So really bringing some disciplines around experience in different parts of the store are opportunities for us that if you say, "Hey, what keeps you up at night?" We'll say, "How do you really nail that?" And that even further differentiates the brand.

Robert William Summers - *Macquarie Research - Analyst*

So do you have a preference to -- so as you talk about dislocations on the market for a lot of different reasons, does it make sense for you to continue to do -- grow organically versus maybe buying off or taking a [stabs at chains] like a -- I mean, I think there's a lot of -- you could advocate that doing it ground-up allows you to do what you want, but just kind of talk through that.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Yes, I think good news and bad news. Good news is we don't have a lot of people who do exactly what we do. Bad news from an M&A perspective, we don't have a lot of people who do exactly what we do, right? So there may be 1, maybe 2 at the stretch. But I think the key thing that Jim, Brad and I always talk about is that if you're going to buy somebody, how much of a -- are you buying real estate or actually buying a business and how close is the business to Sprouts. And there is no business virtually of scale that's close to Sprouts, like exactly what we do. So then you're leaning to buying real estate and to buy real estate -- and if you think about it, it costs us a little less than $3 million to build a store on average, to go pay $5 million, $10 million, $15 million per store and then convert it all makes no sense from a shareholder's perspective. So we always think about it in that fashion is this if the value of our store is this much, how much are you creating value and how much are you just buying value for the sake of buying real estate. So I think we continue to look, but there's no obvious or imminent transactions ahead of us to buy something. But we always keep our eyes open, particularly as we move to new markets, and there are a couple of pockets in the country where we're not in, where it could be interesting for us to look at a couple of things.

Robert William Summers - *Macquarie Research - Analyst*

I think that about does it. Thank you, everybody. Thank you.

Amin N. Maredia - *Sprouts Farmers Market, Inc. - CEO & Director*

Fantastic. Thank you.
