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SFM - Sprouts Farmers Market Inc at Deutsche Bank dbAccess Global Consumer Conference

EVENT DATE/TIME: JUNE 14, 2018 / 8:30AM GMT

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PRESENTATION

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Good morning. Good morning, and welcome to a fireside chat with Sprouts Farmers Market, a fast-growing and unique natural and organic grocery concept in the U.S. My name is Paul Trussell. I am the U.S. food and apparel retail analyst, and I'm very glad to have with me the Sprouts Farmers Market management team, which includes Amin Maredia, CEO, to my immediate right; as well as Brad Lukow, CFO, to my far right. And also joining us here in the front row is VP of Investor Relations and Treasury, Susannah Livingston.

To kick off the conversation, Amin and Brad, would you just start off by walking us through what makes Sprouts such a unique concept? And what is your moat in what is such a competitive marketplace with grocery in the U.S.?

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

Yes. So I think that as far as our moat in the business is concerned, to start with is, Sprouts, since its inception, 2 of our biggest pillars for the company have been health and value. And so we carry fresh natural and organic products throughout the store, and that's all we carry. And value prices is something that we have in our bones from day 1 of the company. And so that by itself, if you look at the U.S. and look at pure-play health food stores, Sprouts is one of the only ones, if not the only large-scale player who is both health and value today.

And in comparison, when we talk about health, we don't carry CPG products, they're Coke, Pepsi, Tide, Frito-Lay products, which makes up generally in the U.S. supermarket, anywhere from 40% to 45% of the sales of other conventional grocery stores, and that is a low-margin business and a declining business.

On the inverse, the natural and organic channel in the U.S. is growing at 6% to 8% CAGR a year. The other trend, in addition to natural and organic that's accelerating very quickly, is fresh foods. And fresh foods are over 60% of our business now and that's something that will continue to evolve and grow and -- which brings me to my last point around differentiation is, we as a company have been always fantastic at produce bulk, which is nuts, trail mixes, grains and vitamins and HBA. And we had -- we saw opportunity several years ago, 3, 4 years ago now in private label, in meat and seafood and deli food to enhance the experience.

And we've done a lot of good work in those areas over the last few years, and that's allowed us to grow our average annual store sales by up from $14 million a year 4 years ago to $18 million a year today. And the next sight is at the $20 million mark, $20 million mark, and whereby, as a company outside of health, we're laser focused on innovating and listening to the customer and focus on trend, so that's what really drives us. So all those things really differentiates Sprouts from any of the 28,000 conventional grocery stores in the U.S. today.

QUESTIONS AND ANSWERS

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

To further elaborate on that point, talk a little bit more about who you view truly as your direct competition. And when you open a store in a new market, where do you see those customers coming from?

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

Yes, that's a great question, Paul. Typically, based on all of our consumer research, 60% of our customer base are coming from the traditional conventional supermarket. And when we look at our trade area maps that we draw, roughly 70% of our sales are coming from within a 7-minute drive time. But customarily, it still is conventional supermarket customers that are attracted to our value proposition. Really, the freshness, as Amin said, 60% of our business is focused on fresh and over 90% of our business is fresh, natural and organic products.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So how should we think about -- you mentioned value in your opening statement. How should we understand your pricing dynamic versus the competition? And then maybe, more broadly speaking, how would you describe the overall pricing environment across U.S. grocery?

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

Yes. So if we look at, for Sprouts, our pricing philosophy is because we don't sell any of the CPG products, which is generally a 10%, 15% margin business for the conventional supermarkets, we've flipped our pricing and value proposition. Our anchor is our produce in a bulk department, particularly our produce department, where we're significantly cheaper than any discounter or conventional grocery store in the U.S. And we're able to afford that because we don't have that center store, 40%, 45% of the business. And we leverage from there, take that to -- and the rest of the store was natural and organic products. We have a fairly complex and sophisticated pricing strategy with over 30 zones in all of our markets. And outside of the foundation of produce, in every market, based on the level of competition in both conventional, specialty, mass, club, we set our price zones by department, by category that have a band on them, with the principle that when somebody walks out of a healthy grocery basket, we want to be, by far, the cheapest in the market period.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

And so on a lot of people's minds, from a grocery standpoint, are 2 competitors in particular, Walmart. How do you compete on price with Walmart? How do you stand from a fresh standpoint? And then also, Whole Foods. With the acquisition by Amazon last year, they've obviously tweaked a number of their strategies. They've introduced a Prime discount. What have you seen in the markets where you compete with Whole Foods? And where do you stand now from a pricing standpoint given their recent actions?

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

Yes. So from a Walmart -- first, as far as Walmart's concerned, in all our consumer insights work, we have very little overlap with the Walmart customer. When we look at the median market, in any market, the median income, the median education, our customers skew above -- at or above the median market. So we always say that early in the markets when we enter, we're focused on the 40th to 80th percentile of customers as we build the brand, build density, build a focus around health and value in the marketplaces then, we use the term internally, then you have license to go outside of those bands and to go downstream below the 40 percentile and above the 80 percentile. So we've always been laser focused on how we enter a market and then how we expand from there. And all of our data shows that the Sprouts customer is just a very, very different customer from a Walmart who's primarily focused on price, right? We're really focused on health, value and experience in our stores, so quite a different business model. I think any one of you who would walk into a Walmart and walk into a Sprouts, it'll take you about 3 minutes to figure out it's a different customer. And then as far as Whole Foods is concerned, we've historically always been in suburban markets. If you take a look at a city like Dallas, we have very few stores in the city center of 5, 10 minutes. And heard this is wise because is at one time, we didn't have a deep food and deli business and so we are very much a grocery store. So -- and we anchor our stores, as Brad said, it's near the conventional supermarkets, so we're much closer to the customer on average. And what we've seen is because of our price -- significant lower price to -- of the full basket to the likes of a Whole Foods, to the extent that they've continued to drop price, we've not seen any meaningful impact on traffic and we measure that by looking at stores which are within 1 minute, 3 minute, 5 minute, 10 minute and no Whole Foods in the market and how did those comps and traffic and tonnage in our stores vary. So we're seeing very little movement there. And the simple analogy is people aren't going to drive past a Sprouts and go another 5, 10 minutes to a Whole Foods to pay more. So we've not seen any movement on that front at this point.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

And you had a partnership with Amazon that recently ended. Tell us what the learnings were from that partnership and talk to us about why Instacart partnership, which is new, makes sense for the Sprouts business today and going forward.

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

Yes. I always think about foundation and principles. As a company and as a management team, we've always been focused on the customer and innovation and adding value where we can add value. And so about 3 years -- actually now, almost 4 years ago, outside of FreshDirect in New York and another company in San Francisco, we were the first in the U.S. to really push on the home delivery fresh food side, same-day delivery. And we looked at the entire landscape of opportunities, including U.S. companies, as well as a European company, that all of you are familiar with, to think about how can we add value in the space. And at that point, through heavy due diligence, we decided to partner with Prime Now. We like the technology that they brought to the table and the experience and freshness and the quality of everything we do in the food business and so we continue that partnership. And of course, since then, we unwound the partnership and picked up Instacart. What I've been amazed by is how quickly the Instacart business has scaled. And I think a lot of that has to do with the brand, the trust, the quality of the product and the execution to the door that Sprouts is able to bring. Today, in the U.S., just about every midsized and above, food retailer has its own delivery or click and collect or some form or fashion, so they exist as a platform. But ability to execute with freshness and perfection or close to perfection to the day is what we think will continue to drive the business. So our Instacart business has grown very quickly. Because our stores are not spaced close together like the conventional supermarkets, we actually see incrementality. I know the European experience is, whether you look at Tesco or other models, because of the sheer gravity of how close the stores together are, the home delivery business has been problematic. I know here, because it's all cannibalization, right? It's an incremental cost to deliver to the customer. But at Sprouts, what we're seeing is, generally, as Brad talked about, is 70% of our sales come from within 7 minutes of the physical location in-store, and our home delivery business is the inverse. And so we really can truly extend the freight area and are driving incrementality to sales, to the EBITDA, both the EBITDA dollars and EBITDA margin of the company. So now that we've gotten good operations and execution through this transition, we're starting to accelerate the marketing of this program because it's offense for us. We can get more market share compared to, I think, other conventional retailers where it's defense where they have to have it so that they don't lose share to the home delivery. But we know it's not a productive activity for them because it's heavy cannibalization, and therefore, just increased cost of the system.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

To your point, there are drastic differences, obviously, in the European and U.S. market. So talk to us a little bit about what is your view on where home delivery for food goes long term. And also, maybe let's weave that into how that has or could potentially change your long-term store forecast.

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

Sure. Very different model currently in the United States, where food from a home delivery online point of view is only at roughly 2.5% of the total $850 billion grocery marketplace. Whereas, if you look at High Street London, that has the most penetration of home delivery and they've been at it for a couple of decades, now at roughly 14%. And within the 2.5% in the U.S., fresh grocery is actually less than 1%. So today, a very small portion of the overall industry within grocery. We continue to expect to see that to grow over time. But I think you're looking at -- to get into double digits, given the geographic landscape of the U.S., it's going to take many, many, many years. Now from a Sprouts point of view, again, 60% of our business is anchored on fresh. What we've seen -- what's critically important is, for that experience with the customer ordering online and getting the home delivery, you better be great in execution when that fresh item comes to your house. It better be quality of level that the customer themselves would pick in store. And so we're extremely happy with the operational readiness and the experience that we've had over the last 2.5 years within the home delivery experience in the marketplace, that we have fantastic results from a customer perspective, on customer review of the level of service that we're providing. So I think we're best positioned. When you look at produce, another area of differentiation, produce is 23% to 24% of the sales within Sprouts, whereas if you compare that to a conventional supermarket, 8% to 10%. So by definition, we are fresh. We control the supply chain logistics from farm right to the store. And we turn produce every 2.5 days. So by definition, we are absolutely the freshest and then our customers are telling us that. We have a tremendous whitespace opportunity in terms of new store growth, and we obviously take that into account, that home delivery will grow over time and it's just another factor that we look at in terms of spacing of our store network.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Absolutely. So on the last conference call, there was an adjustment made to the ID, the same-store sales forecast and partially due to less inflation than initially expected coming through the year. If you can just touch on what was the driver there and what's the outlook now for the balance of the year.

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

Sure. Yes. In the first quarter, we saw some deflation, principally in produce department. That area of the business, obviously, 23%, 24% of our total sales mix, can have an impact on the overall plus or minus on inflation for the company. Now that we're shifting into Southern California for growth in the growing season now shifting, we have pretty good visibility into what the crop yields are looking like, and it's starting to look like pretty consistent to the prior year. So ending the first quarter and into the beginning of the second quarter, we saw some deflation in the produce category. But as a result of that change in expectation, we lowered our same-store sales guidance just from the produce inflation point of view. At this point, we expect some inflation overall, total company, in the back half of the year, which will land us pretty flat from a total company point of view for 2018.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So from a top line standpoint, right, obviously, putting the deflation of produce aside, talk to us about what will be the drivers this year and going forward from a sales productivity standpoint.

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

Yes. From a business model perspective, to the top line, there's really 3 drivers. The first is an e-store growth. We're still at about 30 stores a year, which is close to 10% in new unit growth. The second component of sales drivers is our new stores have strong IDs in the second, third, fourth year, and they mature. So that gives us 100-plus basis points of tailwinds into our comps. And the third element is really around innovation. What I spoke to earlier is continuing to step change the business. Today, especially when you think about the fact that Sprouts don't carry CPG products, the fact that we're over 600 per square foot, puts us as one of -- a very efficient box, low cost of capital, puts us as one of the best retailers in year 2 to year 4, new markets year 4 and existing markets year 2. We're driving 35%, 40% on the cash and cash return in our business. So feel very good about those top line drivers of growth, comps and innovation. And I'll let Brad speak to some additional drivers in terms of what we're doing. We're at a point of the company where we can really take advantage of some scale and efficiencies and I think it's perhaps worth commenting on that also.

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

Yes. We're just at the very early innings of rolling out some technology that's going to drive efficiency within our store operations. So today, we are just starting to roll out a technology all around inventory management, automated demand forecasting, which will help us making sure that we have the right quantity by item on hand, which will result in a lower shrink in the fresh part of the business, again, 60% of our business. It'll also help us maximize sales. Today, in the absence of this technology, it's very difficult to get the right quantities on the right items, get that right. And as a result, you leave sales on the table and your shrink isn't optimized. We're also integrating that with our demand production planning, which will make sure that we have the right product on the floor at the right time based on how much we sell by unit throughout the day. And that will also be integrated with our labor scheduling program at store level. So we're in the early days of rolling that out sequentially by department. We'll be done by the end of the first quarter into the second quarter of 2019. And that's going to give us some tailwinds of efficiencies, which will then make a determination of how much of that needs to be reinvested and priced versus -- depending on the competitive landscape, versus dropping down to the bottom line. But from our perspective, our core competitors have long ago, 1 or 2 decades ago, implemented these systems, and we're getting caught up now. So we have the benefit of those tailwinds coming forward.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So just remind us on that front. What comp today is needed to leverage fixed costs?

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

Yes. We're roughly at 3% to leverage fixed costs. And so when we look out going forward, the benefit of the fresh item management system, that's going to enhance our ability to leverage at a lower comp level.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

And so talk to us about some of the other initiatives from a category standpoint, you've kind of alluded to it. But specifically, what's the strategy from a meat, deli and seafood standpoint?

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

Yes. As a company, one of the things is there are 3 areas, private label, and as you said, deli and meat and seafood. In the private-label side, 5 years ago, we had about 600, 700 items in private label. Many of them were commodity like, I call it, the frozen corn, the ketchup, the mayonnaise, et cetera. And we took a different path at the time to expand our private-label program that was -- that's rooted in health, attribute based, whether it's non-GMO or paleo or raw foods, et cetera, rooted in taste and value price. So we've accelerated that program meaningfully, and that business has grown from -- for us 20-plus percent for years, and we continue to see acceleration there. And we're also starting to see now in some of the categories where our private label is well outselling the large national brand in that natural organic. So excited about creating that differentiator. And our customers who are putting private label in their baskets, those baskets are meaningfully higher and higher margin. So that's one. And then in deli and meat and seafood, we've really felt Sprouts 5 years ago just -- it was not deep in fresh, deli, cooked in the store program and that's a -- it's a pretty big initiative and has been 2, 2.5 years of getting the right products, the right packaging, the right layout. And now we're starting to look at some new innovative merchandising and testing some stores where we're seeing really significant lifts. And it's all about focus on experience, on creating more authority in deli and meat and seafood. And so we're seeing some great lifts in those test stores in those areas, plus knock-off benefit in beer and wine because of the meat and seafood. So I think that, for the most part, we'll apply going forward to new stores those learnings. Some learnings, backwards to existing stores. But again, this is all -- we're at early stages of 300 stores. We'll likely have over 1,200 stores over time. It's a long runway. So I always say the first 300 stores don't need to look exactly like the next 300, and so we're pretty excited about the step-change that in traffic, in sales and profitability of our business model that these new stores will create. So I think those are the major traffic drivers in addition to what Brad talked about, is really building the infrastructure and the technology for scale. And then the last piece, for the last 2.5 years, we've continued to invest heavy in our teams. So when you look at our P&L, most of you, if you look -- most people will go straight down to the EBITDA margin, start looking at the trend and go, woah, what's happening here? And when you back up the truck, it's in the DSE line. And it's been very intentional to spend on labor, on wages and in training. We've more than tripled the training at the company in the last 18 months given our growth. And what we're starting to see the benefits of that now in our -- well into it on the customer service scores, on our employee turnover, I always use the word retention, I hate the word turnover. Retention is much higher despite unemployment being record high -- record low in the U.S. And we're also starting to see employees' preparedness, our team members' preparedness to get promoted to the next level. A much greater percentage of our team members are, what we call it, is in our readiness index for next level work is much higher today. So that's exciting because as some of this work completes around technology and infrastructure for streamlining, it allows us to think about the pace of growth. And would that number look different or higher, we want to be in the position to be able to answer that question in 12, 18 months.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So what are the puts and takes from here on EBITDA margin? Obviously, a lot of retailers have been speaking about labor, speaking about freight. Give us an update on that outlook. And then also, just taking a step back for all of us analyzing the company, how should we think about the longer-term algorithm of this company from a top line margin and bottom line growth standpoint?

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

Yes. No, it's a great question. From an EBITDA margin point of view, as Amin pointed out, we were making -- we made some incremental investments this year. We have taken 1/3 of our tax savings roughly and are investing that in our team members in terms of improved wages and benefits for all the reasons that Amin mentioned. So that allowed us -- this tax benefit has allowed us to actually get ahead of some incremental minimum wage increases that were coming down the pipe in a few states in 2019 and '20, so we got ahead of that this year. When we think about efficiencies, the fresh item management is going to drive operating margin opportunities that we do not anticipate all to be invested in price. The market will determine that. But those are some pretty significant tailwinds that we have from an operating margin point of view. I would also say that we're continuing to drive private-label penetration in our stores. Today, it's only at about 12%. Many of the categories are close to 20%, we see, because produce represents 23% of our business and not much private-label in produce. That's why our overall penetration would seem, from the outside, a little bit low. But we see, from 12%, over time, gets to 15-plus-percent. And obviously, a better margin comes out of private label. It's not a national brand knockoff strategy, to Amin's point, really focused on unique products, formulation, taste profile, packaging, that's really resonating. So there's some tailwinds that are -- will continue to help us from a top line sales point of view and margin point of view. And we continue to see very strong performance in the non-fresh areas of our business. We've put a lot of emphasis on the vitamins and HBA area of business. And we put a lot of service to our customers who've really grown to look at Sprouts as a destination place for that type of product and that service, that assistance, the knowledge. So those are a few factors that will enhance margins going forward. I think the competitive landscape will remain at similar levels. Our expectation, it's not going to get easier, but we've had these tailwinds that we believe, over the longer term, we are able to sustain our current EBITDA and EBIT margins.

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

The one thing I would just add there is just so all of those puts and takes sort of makes the management team and the board, we feel pretty comfortable that we're in double-digit sales growth and double-digit EPS growth. And when you look at the ROIC of the company, when you kind of really take a step back is, when I started in 2011, we were at about 9% ROIC and it's consistently moved up to over 14% today. And as these efficiencies start kicking in, as well as we think that this new -- as we test these stores and continue to drive that $18 million up, we think that number continues to move up into the right. So we're pretty excited about, despite of all the short-term inflation, deflation, when you kind of take of step back and look at the company and look at the company's growth of double-digit sales growth and EPS growth in the teens and the ROIC that's just getting stronger and stronger, I don't lose a lot of sleep over temporary deflation.

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

I would just add to that. Obviously, the tax reform has only strengthened the financial position of the company. And looking forward over the next number of years, our effective tax rate is going to be in the 25% range, whereas historically, before tax reform, it was 37.5%. So that's now driving total company ROIC above 16%. That, combined with the fact that our new store productivity is -- it continues to be very robust and above historical levels, which only means that your financial returns are stronger.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So talk about then the cash flow generation of the company and how you prioritize that cash usage.

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

Sure. Again, we have a very capital-efficient model. Our average capital for opening a new store is $3.4 million. And depending on whether the store is in an existing market, one of the original 8 states, or a new market, they mature in roughly 2 to 5 years, generating a 35% to 40% cash-on-cash return. So by definition, the company is a huge cash flow generator. Our priorities are, first and foremost, to grow the store network. We're currently opening approximately 30 stores per year. At the same time, we're balancing opening those stores with the important initiative of driving these efficiencies by installing the fresh item management system across the network. And we'll make a determination going forward, whether when's that's behind us, whether we step up and accelerate the number of units going out into those new markets. From a -- after the priority, obviously, on organic growth, we're returning excess free cash flow to shareholders in the format of a buyback program. We've announced consistently we're going to be in the range of 1.4 to 1.7x net debt-to-EBITDA, which we think is a prudent level of leverage on a lease adjusted basis that equates to about 3.3x leverage, so we're very comfortable with that. And the excess free cash flow, returning that to the shareholders, is just part of the overall shareholder value-creation model.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Circling back to some call-outs and hot topics from the last quarter. You were discussing a tightness in produce supply. Can you just maybe update us or, first of all, inform us how did that exactly impact the first quarter and what's kind of the updated outlook on that front?

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

Yes. In the winter months, Brad spoke to this, is from October to February, tends to be where the weather patterns or something from outside the country can have an impact on what the outlook looks like. And so this year, we went through a deflationary period. And the deflationary period was driven partially by some of the heavy inflation last year and then also certain other categories seeing excess supply and really driving prices down and costs down into the marketplace. So as we're sitting here today, we're starting to turn through that cycle and so we're back to a normal cycle. The crop -- summer crop looks good. I think last time at this conference, I said that in like 3 days later, we had a massive hail and wiped out 40% of the cherries, so I should find some wood and knock on it here. But no, nonetheless, in the back half of the year, this feels a lot more normal. And I think the key thing for us is, when these types of periods happen, I go right to traffic and tonnage. And tonnage being in produce, in bulk and meat and seafood, what does the tonnage look like on the volume that we're moving in the store and then what does traffic look like in the stores, and both of those look pretty healthy. So it's sort of the core metric that you certainly lean to when you have heavy deflation or heavy inflation to make sure that the business is strong and nothing in the boiler room is burning.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Absolutely. So also, you've been talking about your strategic investments. You've recently launched or relaunched sprouts.com and your mobile app. Exactly how is your customer utilizing those tools? Or what are your expectations?

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

Yes. Our expectations when we look -- we continue to broaden out. At one time, we used to say health, selection, service and value, and the service element broadening it out to more of experience, and that experience is really in the store and outside the store and thinking about the user experience. And so even when you go to our mobile, web mobile or app, what we want to really frame this is in health. And it's not about what's the price we don't sell it or what's the price of Tide on the front page of the mobile app or the website, but it's really around health. So there's some unique things that we've done around staple, trending, unique, as we call it staple, trending, unique in items that are creative and supported with pretty unique recipes and being able to drop all the items into the basket right there in your shopping list. And then also we're working on an integration to be able to then just, with a one click, get it delivered to the house. So that's efficiency for the customer. And we're also spending increasing energy on bringing the fresh products forward and the deli products forward on to our website because we know the way in the U.S. consumers are eating continues to change. People are very cognizant of health. They're very cognizant of time. And I use -- we use the term ready-to-eat, ready to heat, ready to cook. So more and more Americans at the dinner table are buying groceries and cooking from scratch. Maybe they're doing it more on the weekends. But during the weekdays, that pattern of having the food options, the fresh food options of something I can either just eat in the store, in the car or go home and heat it or the retailer has already done all the work with marinating the fish or the meat and has all the vegetables diced and throw it in the oven and you're done in 7 or 12 minutes. And so that eating pattern is sort of a macro trend we see continuing. And so we're positioned really well with what we have in our store being heavy fresh to be able to execute on those programs. And those are some of the things that I spoke to about deli and meat and seafood we're doing that's really starting to resonate well. And so we want to accelerate those types of activities through all channels, including online and home delivery or click and collect.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So big picture, natural and organic, maybe you can just update that on current trends of the overall marketplace. What's your medium and long-term view? And are there any call-outs for natural and organic from a demographic or geographic standpoint?

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

Yes. It's continuing to get towards mainstreaming and a tipping point, if you look at just the packaged items, so just frame $850 billion industry in the U.S. The packaged side, natural and organic items, are $120 billion today. On the organic side, when you look at produce, and produce, by definition, is natural, and the organics and higher-quality natural meats and sustainable seafood programs, when you look at those elements of fresh and health, it started off as about a $20 billion business 25 years ago and it's $200 billion today of the $850 billion. So Americans are definitely starting to watch what's in their pantry or what's not in their pantry with all the medical issues. And whether it's diabetes or cancer or increasing heart issues and cardiovascular issues in the country, it's starting to affect every generation. It's just not -- as you're getting older, we're seeing young families be very cognizant of what they're feeding their kids. So we feel really blessed and in a great position, frankly, to take advantage of opportunity, while others, conventional, the 28,000 conventionals, many of them are struggling in that one unique lever, which is called price, and that only gets you so far in a 2.5%, 2.7% EBIT margin industry. What it basically does is it doesn't give you capital to reinvest in the business. And so we see of the 28,000, probably 5,000 to 10,000 conventional grocery stores go away over the next 5, 10 years in the country. And the ones -- those on the edges, the discounters and the special or the differentiated models, those on the edges probably pick up the share.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

So we only have about 1 minute left and I'll turn that back to you if you have any closing remarks.

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

Yes. I think we've covered a lot of this and serve just a reiteration of the business and business model of the trend as not only natural and organic food, but also just health and fresh, but I touched on fresh several times and that's a macro trend we see in the country. We see sugar or lack of sugar in foods as a macro trend in this country -- in the country. And so as we see macro and micro trends, we sit right within there. And as a company, I said this earlier, our focus is never being satisfied at sales per store, whether it's in stores backwards or stores forward, and how do you move the wall forward, and we feel like we're really well positioned to continue to take market share. And we have the right size box at 30,000 square feet, you're not overexposed. And I think as home delivery grows, as fresh grows, if you're sitting on a 60,000, 80,000, 110,000, 130,000 square feet box, you've got a lot of SKUs to fill, and you can't fill them with fresh because that's not going to take you very far to hammer strength. So when we pull back up and look at the long, long-term view, we do think that health, on trend, convenience, including box size or to the home, the brands who are -- hit those buttons and value are going to be the most relevant. And a lot of times when people us ask about M&A, the response is interesting and that's saying there's good news and bad news. Good news is there aren't too many who do what we do. Bad news is that from an M&A perspective, there aren't too many who do what we do for a living. So opportunities, even though there's 40,000 stores in the country, aren't as wide because the differentiated model that Sprouts has doesn't exist out there in any heavy numbers. There's a couple interesting things that we always keep our eye open on as they already shake loose, but we'll continue to take advantage of real estate certainly as retail compresses in the country and keep growing the business organically or otherwise.

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

I would just add one final point. While we're at 300 stores today, we are in 17 states. We're only deeply penetrated within 8 of our original states. And we see tremendous whitespace opportunities going forward in terms of unit count growth in some very attractive marketplaces that we haven't been operating in the past. So we're very excited about that. We're excited about the model and the brand recognition that we're getting in the new markets that we're opening up and we're very excited.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

And those markets that Brad talked about was more from a distribution supply chain expansion perspective was to naturally flow east and now we're fairly well positioned, a few from Seattle, all the way to California to the middle of the country. And as you go up to East Florida and then going up the East Coast, we just entered the Mid-Atlantic, being the Pennsylvania, Washington, D.C. and Maryland area, and then continue to go north from there. So we feel pretty well positioned to have a core distribution channel now really to take advantage of areas of the country where the population growth is the highest, income growth is the highest and job creation is the highest and cause a smiley face of America kind of working its way, technical term there, and continue to grow the business.

Paul Trussell - *Deutsche Bank AG, Research Division - Research Analyst*

Thank you, Amin. Thank you, Brad. This concludes our fireside chat with Sprouts Farmers Market.
