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# EDITED TRANSCRIPT

SFM - Sprouts Farmers Market Inc at BMO Capital Markets Farm to Market Conference

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## CORPORATE PARTICIPANTS

**Jim Nielsen** *Sprouts Farmers Market, Inc. - President & COO*

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

## CONFERENCE CALL PARTICIPANTS

**Kelly Bania** *BMO Capital Markets - Analyst*

## PRESENTATION

**Kelly Bania** - *BMO Capital Markets - Analyst*

Right. We'll just get started here and sit down. So Sprouts is our first presenter this morning. I'm really pleased to have Brad Lukow who is the new CFO of Sprouts and Jim Nielsen, who is the President and COO of Sprouts. Sprouts is one of the most differentiated concepts in grocery retailing today, with a very unique focus on produce, promotional intensity, value and I think authenticity in the natural and organic segment. And with I think just over 200 stores today, the Company is on a path to reach its longer-term store growth target of 1,200 with probably low-double-digit growth for many years to come. So thank you for joining us this morning.

So my first question, I guess, is with Sprouts focused on produce and it's about a quarter of your business, there is some volatility in terms of availability of produce and pricing, and it seems like the last year has been maybe more volatile than most, but maybe if you can just comment on that and put that into perspective over the last year and remind us what we should expect kind of month-by-month here as we cycle the port issues from last year, the extreme produce depletion in the spring and summer months, and what we should be reminded of us as investors and how that can impact the Company?

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**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

That's a long question. So I'll kind of reflect back to 2015 and just to refresh everybody's memory around the impacts to Sprouts business as a result of the port closure. So last year, the first part of the quarter, we saw a slightly inflationary market due to the port closures. And when they opened up, there was a flood of them and port products available, grapes, blueberries, grass, several other things as dairy goods for those people that -- it's hard speaking up the produce language, and that kind of continued throughout the second quarter.

This year, while we had some challenges very little bit different in nature, we started a bit inflationary and it just tapered towards the back half of the quarter. As we look forward in produce, we kind of see kind of a neutral to potentially slightly inflationary environment for the rest of the year. When you talk about volatility, what can you do, what do we do as an organization to protect against that. One is that there is nothing you can do when you have a market that's completely gapped. I'll give you great example. We had hailstorms in the southern California at cherry crop last week, which put an immediate stop to the cherry. So when something gaps like that or season ends early, there is nothing new, because there's no supply. But then we look at other things in terms of tight markets and what you can do to protect yourself there, what we do is, obviously building pro-relationships and you can set better direction around planting, so you can give more contract-based or guidance around planting implanted commitments.

The other thing we've done and I know everybody who talks about we're a produced-centric company, I think, we're much more dynamic than that. I appreciate the fact you call us an authentic natural retailer. But we continue to enhance the -- all the departments around the store and that's on our assortment, our pricing, innovative products and innovative promotions. So becoming more multi-dimensional as opposed to just tinkered on produce.



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**Kelly Bania** - *BMO Capital Markets - Analyst*

So as you kind of work on some of these other departments of the store, should we expect the mix of produce to remain stable longer-term or will that come down as you kind of --?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

I mean, it's come down a little bit, but it's not near material enough to discuss, but we've seen a positive mix. As we mentioned in our conference call, our non-perishable departments continue to outperform the industry in all channels for that matter. So, we're getting a better mix, we're getting enhanced basket, but in order to materially shift 25% of your business would take significant change. But we see that shrinking over time, but it will never get below the 20 percentile number.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Is there anything else you can do to reduce the volatility when there are these gaps or these tightness or is that just -- that just comes with the produce market?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

I mean, like I said, there was a difference, the tightness, the growing relationships, the commitment on planting, being dynamic in your offering. So we've obviously, we have continued to grow our organic offering at Sprouts. It's well over 20% of our business today. But when you run into gap, it's going to be a challenge. There's going to be a challenge for everybody, and so it kind of creates a neutral environment.

**Kelly Bania** - *BMO Capital Markets - Analyst*

And when you talk about for the rest of the year neutral to slightly inflationary in produce, is that a good environment, is that okay, is that -- how do you --?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

As we have, I'm looking at entire basket for produce, so as you look at, you want to -- even though everybody looks at CPI and PPI, those are simple indexes. Our basket is a little bit different than that. So if you have something that runs into a gap, berry, for example, there's 25% inflationary and throughout the rest of the department, you mix out to a somewhat neutral environment, it still could be, put pressure on us because of the promotional opportunities that may be missed. But as we look out into -- and I don't like to look too far out because you do have multiple growing seasons and a lot of things can change and Mother Nature has been very unusual over the course of the last 18 months, but as far as we can see, the rest of this year looks very stable.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Lots of questions on the competitive environment, I know we talked about this when you reported a couple weeks ago, but are you seeing anything different? There's always pockets regionally I know, but how would you characterize it today?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

As I mentioned on the call, from a sequential basis, Q4 to Q1, the number of outlets, it's fairly neutral. We did get the benefit of Haggens in Q4, which we called out on our earnings and Q4, was 25 basis point pickup that we didn't get it in Q1. But from overall number of outlets, fairly neutral,

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and I'm talking the total count. We always track the total count. We have seen the smaller formats grow a bit, all these open up in Southern California. We haven't seen any impact to the stores that we have within three miles of those locations, so I'm excited about that. So outlets fairly neutral.

Pricing, we've recently seen some investment in some markets. I wouldn't disclose which markets those are and we react to it, [sticking] with our pricing strategies, but they're not material, not material enough to impact gross margin. And then from our promotional kind of landscape, we continue to see approaching a position that people have taken kind of beginning in Q1, but we also see that in Q2. And with beef prices coming down a little bit, I anticipate that will continue through the quarter.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

And that's pretty natural when there is a depletion in the category like that to see more promotional activity, right.

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**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

Absolutely. And certainly, replaced critical items provided to us as well. So people will go after the opportunities and try and get the right retail price points, so, carry footsteps in store of course.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

You mentioned some of the small-box formats, all the Littles coming in the couple of years, you've got Kroger testing Main & Vine, Whole Foods is launching 365 next week. What do -- do you think your competition -- your competitive set will shift more towards some of these focused small-box retailers or do you think it will remain the traditional supermarket as it has been?

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**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

As we've always said, we compete with anyway sales groceries, so whether it's 12,000 square foot co-op or 100,000 square foot conventional store, we view them all as a competitor. So I think everyone knows the growth in terms of per unit growth is in the smaller format stores, but the breadth of stores, is still in 50,000 square foot conventional format. So that's still continues to be a primary competitor, but as you stated, we continue to see growth in the smaller sized format.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

And what -- you guys normally go to ICSC every year, just going to ask about real estate and the availability of that 28,000 square foot to 30,000 square foot box.

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

So we've mapped our real estate strategy looking forward five years and we have a great understanding of who our core customer is. We look at demographics, household income, family members, of course, competitor set in each of the markets. And so, in terms of visibility and sites that we've signed up probably, about 55 sites in the pipeline right now and most of the lease is signed, pretty good visibility. You do see some retailers shuttering stores, represents some additional opportunities in various markets. But I think, the 28,000 square foot to 30,000 square foot, is pretty good spot for us and we see good availability.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

Are you seeing rents start to increase a little bit for any of those prime locations or --?

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

Only in certain pockets of the US. But for the most part, when we're pushing east, we see pretty good rents.

**Kelly Bania** - *BMO Capital Markets - Analyst*

In terms of when you look at the different categories in the store, produce is the focus, but you mentioned kind of broadening a little bit of focus to some other categories over time. When you look at the store, where do you feel like price-wise you can make a better impression with the consumer?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

That's how we make a pretty good impression most of the time and our customers tell us that in the feedback that we get. Again, we're a value-priced concept, so the spreads that we have in produce really help us anchor that philosophy. But as you look at the four walls, we're competitively priced throughout those four walls on items that are relative to the conventional retailer or natural retailer.

So, I feel like today our pricing position on the strategy that we have today are the same strategies we created the tailwinds that we have and continue to create tailwinds in the non-perishable environment. Things can obviously change, we'll continue to evaluate those as we get more technology on the BI/DA side. We'll be able to go back and look to see how we can make changes, but right now, we feel very good about where we're positioned.

**Kelly Bania** - *BMO Capital Markets - Analyst*

And just a reminder everybody, if there's some questions, you can submit to me via the iPad or I can just keep going for long time here. So I guess the same question on merchandising. So price-wise, we talked, but merchandising, you're doing some things in deli, see some opportunities there. Can you remind us what exactly is changing when you go in and make these deli upgrades, how many stores, longer-term potential?

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

We see a trend in consumer desires for more the deli offering in terms of convenience, HMR cases, we're putting in salad bars, juice, coffee stations, prepared food service cases and we're seeing great traction. It's early days, but we've reported for the first quarter, we've done about 24 stores evenly split between existing retrofits and new stores. Looking out for the balance of the year, I think about 70% of our new stores will have some elements of the expanded offering.

And when we think about the existing store base, over time probably a significant component, 50% plus of those stores would get the expanded offering. So the early results in terms of sales lift that we're seeing and the customer reaction has been very favorable. So we're encouraged that we're delivering yet another value-add basket expanding for that customer. And we look at in terms of existing locations, what is the traffic at 12 o'clock, 5 o'clock and really speak to the convenience elements. And so we've got a good pipeline in terms of stores to retrofit balance of the year, next year and going forward with our new store base.

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

And Kelly, one thing important is that while, a lot of people are expanding their delis and then we see that in our competition as we visit our stores, but we listen to our customer. We go back -- every year we do customer research and they give us great direction on what they want in the store. And so a lot of our sales initiatives are driven from small gaps we have in the business, but really what is our consumer desire, what is today's consumer, what is tomorrow's consumer desire and then we can see -- apply those changes.



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**Kelly Bania** - *BMO Capital Markets - Analyst*

I think that's a good segue into just the business intelligence work that you're doing and I think you have the app now with coupons, where does that take you longer term? What -- do you think that's a differentiating factor today or do you think that you just kind of have to have -- be in digital and have coupons?

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

I think you have to be there, but I think we're doing a little bit differently. We've just recently rolled out our mobile app, which allows for a lot of customization, customers can self-select based on their desires for different types of food, whether it's vegetarian, vegan etcetera. And we push out relevant coupons based on their history, their purchase history. We're using this also and it's early days, but to push out new product introductions that are relevant to consumers. We are just launching a Business Intelligence group. We've invested in infrastructure. The team is being built as we speak, which will give us much greater insight into the promo effectiveness, what's relevant for us, for the customer, how can we be more effective in that regard.

We have interactions, 2.5 million a week in terms of social media, Facebook, Instagram website, eCirculars already. So the big opportunity for us is to get the one-to-one communication through this mobile app. We have now -- even though we just launched it, 400,000 unique IDs and we see that building every single week. So I think we're in a good space in terms of building out something that's particularly relevant that's going to add value to the consumer, that's going to build loyalty, we can push out more information whether it be vitamins or different types of dietary needs for the specific consumer.

**Kelly Bania** - *BMO Capital Markets - Analyst*

One topic we've been doing some work on it at BMO is this ingredient reformulation. We've seen some of the large CPG companies really upgrade their ingredients. We have Organic Capri Sun now, we have Organic Heinz Ketchup. What, I mean, how do you guys think about those trends? Would you carry those products in your store? What do you think of that?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

Some of the largest CPG companies own some of the natural companies now. Something we've anticipated for a long time natural from a big CPG is nothing new. Doritos, I think, in 2000 came out with a natural product. What do we do our end, we want to make sure that we have a level of authenticity and I think the brands that we sell on the natural segment provide that to the consumer. And they associate those brands with Better-For-You ingredients. And so what we continue to do with those partners on the natural side is work towards exclusives, product development, promotional development, not only strengthen our partnership with them, but be on the cutting edge so that we can give our consumers that are shopping our stores something new and hopefully something exclusive to Sprouts.

**Kelly Bania** - *BMO Capital Markets - Analyst*

So I have a couple questions here on the app. What is your store roll-out strategy? Someone is interested to know whether your target zip codes are where Whole Foods has been around for a while or are you targeting new markets?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

As far as the roll-out and as Brad alluded to it, I mean, we're in the early stages. It was a soft launch that we did. We had some signage in the store. We haven't promoted it to our customer. We wanted to make sure that we've ironed out some things on the app, make sure that we had enough coupons to make it robust. We still feel like there's a lot of room there for us to enhance the app, so we'll continue to do that, but we'll roll out in a



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methodical way. We're going to do more of grassroots in our store locations, so that we can actually connect to the consumer and describe more what they're going to get, maybe provide a little bit of incentive. But we'll do it market to market, we won't disclose which markets, but it's going to be a three-month process and the rollout -- the real aggressive rollout will start in June.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

Okay. One question here just asking just about big data and customer analytics initiative. What do you know about your customer? What would you like to know about your customer?

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

I think we know a lot about our customer in response to all the surveys we've done over the years. So we have great visibility based on those surveys. I think, what we wanted learn more about this customer is going to be enhanced through the digital app and getting much more analytics around what is in the basket. As we know the big draw initially into the store is through the produce area and then we know over time that that customer branches out into meat, deli and then over time grocery and vitamins. So I think we just want to leverage all the data that is available to understand of how we can be more relevant earlier in that customer's journey, and again, promote offers that are meaningful for the customer.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

Do you know what percentage of your customers are already in that vitamins and supplement category?

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

We have the five segmentations we talked about and the diet devotee is one who is more of a dietary needs, it's 20% of our customer base, but we don't know the exact number. I would say, it's -- I don't want anyone to quote on it, but it's coming primarily from that customer of what we have seen is the health enthusiasts and the want to be healthiest of people that are trying to improve their health, but just don't know where to start. Our footprint, our format, the design, the prices, the promotions, the engagement, the knowledge provides a nice gateway for them to come and feel comfortable in that early experience. What we are seeing is that trial transition lifestyle accelerating kind of bring it back to what kind of comps we continue to see on that vitamin side and HBA side, as well as the performance we have in the early stages in our new store performance.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

So you're seeing that transition happen faster in the short --?

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**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

I'm just making a few assumptions based on the comp rates and the transactions provided to the basket, but I think, it's more, people are early adopting. I think people are becoming more aware of what the products are and the attributes and when they want the breadth and depth of product, they come to Sprouts.

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**Kelly Bania** - *BMO Capital Markets - Analyst*

Another question here on the deflationary environment in beef, do you think there is a shift when you see this towards retail and away from restaurants when there's a deflationary environment in beef? That may be a tough one.



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**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

It's pretty -- I mean, let me, the only thing in restaurants and it's more in the prime choice environment, remember, we sell natural choice beef, so it's a little bit different grade than most retailers would sell or any restaurant would sell. And it's fairly early in terms of the beef prices changing and it's more on the ends you're seeing it than middles, meaning, primals, plates, New Yorks, T-bones, but it's too early to associate any correlation between those two.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Question on when you're looking at your new store growth and targeting where you would like those stores to be, how much zip code analysis you do, how much competitor analysis you do, specifically asking about Whole Foods and will you locate next to them, does that matter? How do you think about that?

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

We have a lot of data that we bring to bear on the full analysis by market. Looking at competitor set, we do have access to these data. So we know, we bucket our customers into many different groups and we correlate back to existing performance of stores in different markets as to reinforce the data analytics. There's 40,000 grocery stores in the US and we compete day in, day out against all formats. We look at demographics, we look at, in a trade area, where the traffic flows are. We're typically suburban. We have opened stores in urban markets as well, but I think typically suburban.

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

Brad, myself and Amin, and of course, Ted Frumkin, our Head of Real Estate and Construction, sign off on every site and we visit every site. So along with all the analytics that Brad talked about and the MOSAIC analytics that we look at, we look at trade dollars to -- what trade dollars within a market. And if there wasn't a grocery store in a market, we would be -- we'd have less propensity to go into the market. So the more competition for us means more trade dollars and a greater opportunity for us to be successful.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Can you talk about your partnership with Amazon Prime. How exactly does that work? How it's being going? What do you think of the future of online grocery?

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

So the partnership is in its early days. We are currently in five stores in three markets; San Diego, Los Angeles and recently in San Jose. So the partnership with Amazon Prime, now members use the Amazon app to access our products that are picked in our stores, mostly from our employees, but also employees of Amazon in our store and then it's a home delivery model. So while it's early days, we've been quite a little bit surprised by the take-up and we are always wondering, whether how much of this was going to be pure incremental sales and when we analyzed the data, we see a couple things; one is, we are seeing great incremental sales growth as a result of this, and the basket is actually a bigger basket than our typical experience.

So as I said, it's early days. I think, we're looking to deepen the relationship as we've seen some good results. So we're in ongoing discussions with additional markets that we like to move into that both of us are interested in expanding the program. Where it goes, it's too early to tell, but I think it could be some combination of this home delivery model, which works better in major metropolitan areas. It's kind of hard to do, if you look at the suburban market, just the cost of delivery, generally becomes too difficult. So it could be, a roll out, it could be a couple strategies, it could be click-and-collect, as well as the home delivery in certain urban markets.



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**Kelly Bania** - *BMO Capital Markets - Analyst*

Now my next question is on click-and-collect, have you've guys tested that? Do you think about that?

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

We haven't, but again, through the customer insights work that we've done and are currently doing, we want to make sure we're staying with the trends and delivering to our customer what they're interested in.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Another question on the app here. Asking about Canada, do you have any longer-term aspirations to expand up into Canada, why or why not?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

We're 1,200 stores in 48 states is what we're focused on today. But looking that far, as we grow, we have to create the natural supply chain and we want to make sure that we're methodical in nature to make sure that we continue to deliver against the brand promise and that is our number one focus is. It's really easy to open a store, it's hard to, to make sure we operate them consistently every day and that's where our focus is, is just trying to find a high level readiness for our team members, so that we can continue to expand. But our network will kind of follow our supply chain, so in order to get that far north, it would take in excess of probably five or six years and no plans today.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Can you talk about shrink in your business? How do you guys manage it? You have a lot of produce obviously. Is there anything different in how you manage shrink or is there any opportunity to improve shrink?

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

I think if you look at our business, 50% is perishable. So we've always been very diligent in managing shrink very carefully. I think in areas like the expanded deli and even in the meat area, more of the prepared value-add, we are implementing new tools and processes to make sure that our stores are well equipped to -- you don't have the right amount of shrink, because retailers, I think, can make a mistake just targeting to lower shrink because if you have too little shrink, then you're not open for business. We want to make sure that we're ready for business. We have the cases full, so if the customers and shoppers in at any time in the day, it should look the same. But new tools and processes to really help the store with demand forecasting having the right amount on hand.

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

The fundamentals are essentially the same as any retailer would use for high levels forecasting Brad mentioned. So there's nothing that we're doing that is out of the ordinary. It's just continuing to reinforce that habit. I think, just to Brad's point, what's just different about us? We want to be aggressive in merchandising. So as we measure shrink, we also measure people that are below allowable levels of shrink to ensure that we're maximizing sale. So we look at those as diligently as we look at those who are the outliers with excessive shrink because we feel like we may have had a sales opportunity business.



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**Kelly Bania** - *BMO Capital Markets - Analyst*

In terms of trends, are you seeing any new trends. I mean, we've been hearing about some for a while, gluten-free, non-GMO, raw. Is there anything new emerging and how do you just feel about innovation overall from your suppliers?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

I mean, it's still a little bit more of the same. I mean, prebiotic, probiotic is, it's been something that has got some strong tailwinds not only on the dairy side, but the vitamin side of the business. We see that number, sports nutrition, which has been a challenge for the natural segment because of some of the artificial colors and ingredients that have been in the products and people are coming out with some really nice new products, but it's the usual suspects.

I'm still seeing non-GMO grow at a great pace, organics, gluten-free and those are such big categories to see the growth rates that we see as meaningful. The others, the paleos are such small categories, don't, while high growth in terms of percentage, not a lot of dollars, but we're always on the leading edge now. We're taking far more risk on the product and innovation side, not only on the private label side of the business, but the package side of the business to just ensure that we have that that breadth of product for the consumer that has a dietary need and so we can meet that.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Another question here. In terms of the buying produce, is there anything different that you guys do in fine produce? What are the different ways that you can make sure you're getting the best quality, the best supply and the best price?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

(inaudible). We do things similar to others. I think our ability to be super dynamic is key in how we go to market and our flexibility with our growers and those relationships and partnerships when there is, we called about -- we talked about a tight market, a gap market, but there also [flash] markets, which are great markets to be in. When you run across something like that and having a partner that, that can have something in a store in 48 hours and put a price on it that, that could move great deal of products.

So we don't want to give get too much detail of what we do. I'm comfortable with our current QC process that we have around the quality product that we have. We meet USDA Standards Plus, I know that there's sometimes questions around that, but we are USDA Standard Plus on all of our products. We continue to evaluate sizing a product to make sure we're delivering what a customer wants. It's not about what Jim Nielsen wants or Brad wants or Amin wants, it's about what does our consumer desires. So as we continue to look at the variability of those account sizes, we let the consumer drive those decisions for us and we continue to experiment with different sizing on Sprouts.

But comfortable with around -- on a quality standpoint, buying practices and even more comfortable today than I was, last year when I felt happier in terms of where we're at on the supply side with the business with our growers and our partners, because it's -- you got to have the product in order to sell it, doesn't matter what kind of price you got.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Just a function of where the market is, is that your --?



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

It's part of the market, but it's the part of the great job that our procurement team has done by getting out spending time in the fields, partnering with the senior leadership, making commitments to them, so that they're protected as well. This is not a win-lose, partnership to win-win. So we've just done a really nice job of getting that focus not only on the organic side of the business, but the conventional side of business, and it's something you've got to continue to do and continue to focus on and it's in the forefront of what we're doing today.

**Kelly Bania** - *BMO Capital Markets - Analyst*

We've a question right here.

## QUESTIONS AND ANSWERS

**Unidentified Audience Member**

I was wondering with organic being [important part of] your business and in fact, Costco and also Walmart are taking [big way with its announcements], what are you going to do as, (inaudible) and there's going to be more of a focus on farmers getting into it, it still hasn't come to fruition. So what are you going to do for supply in that respect?

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

As I alluded to earlier, we're already doing planting. Costco getting into the organic business or Walmart getting organic businesses, it's not something that was discussed in the last six months. It's been something that they talked about for two years. And I think a year ago or a year and half ago and I don't want to speak here, people talked about I think, Kroger getting over \$1 billion. We're going to get run rate over \$1 billion at the end of this year and we're less than \$5 billion Company. So, we continue to secure those.

Our growth rates in organics continue to beat the market. We're actually expanding variety and I think that's helping with our partnerships, but we're communicating better on that front as well.

So from a supply side, if you were to look at last year versus this year on organic milks, butter and produce, it was much tighter last year. And I think the manufacturers and in fact, we have people here from (inaudible) are in a better position. The yields are better because we had some rain. So the production is better and we'll continue to make sure that we're forecasting communicating to our manufacture partners about where we're headed and where we see the growth being so that they can be better prepared. And when we make a commitment, we're going to stand by -- behind our commitment.

**Kelly Bania** - *BMO Capital Markets - Analyst*

We just have like 20 seconds left. So just one last question here. You have a lot of growth over the next several years. You are vesting wages. You're in food retail. It's a competitive section of retail. What do you think is your biggest challenge. What do you think most about as you look at your plans over the next couple years?

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

I would say, we're a high-growth Company. We have a long runway ahead of us in terms of net new stores. The thing that we always talk about the most is the human capital. We have to make sure -- and that's why we've talked publicly about making additional investments in training of our people, investments in wages to make sure that we have the right compensation level, the leadership training beyond just product training, but it's the leadership training because we need leaders to lead these stores in new markets.



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And so I think, we could grow faster. We often talk a lot about is it the right pace, but for us, we want to make sure we do it right and that we have the human capital component dealt with and be very solid on that front. So I think that's the biggest challenge and focus that we are on.

**Jim Nielsen** - *Sprouts Farmers Market, Inc. - President & COO*

And it's the human capital in terms of readiness and we've talked about where we're investing on the training side, the leadership development, the product side, the process side. But even more than that, it's making sure that you still have that connection you had when it was a small grocery store that you have that connection and under Amin's leadership, he's been very adamant about making sure that the support office is spending a good amount of time in the stores, out there supporting the stores, understanding what are we doing, how can we help, building those relationships and that's what's really important is, making sure that there is this human connection between the support office and the store, because of this growth pace. That's one thing you're going to fight, so we got to make sure that we're visible.

In fact, Amin is probably out in the store right now, but be visible to your team members and really hearing what you're doing and we constantly get every year team member feedback and one of the things that they wanted is more training, more development, which I appreciate after getting that feedback. And we'll continue to listen to them and we'll continue to be more visible and be at a higher state of readiness. That's -- the one thing that keeps us up is making sure we're ready for the next tranche of stores.

**Kelly Bania** - *BMO Capital Markets - Analyst*

Great. I think, we'll go ahead and wrap it up there. But Jim and Brad, thank you very much.

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

Appreciate that. Thank you.

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