

# **Sprouts Farmers Market (NASDAQ: SFM) | Long Recommendation**

**The Wharton School of Business | W&M 2021 Stock Pitch Competition**



**AYINA ANYACHEBELU, MACY HUANG, CHARITHA MOPARTHY, BHAVYA SHAH**

Pitched Price: \$24.05 | Probability-Weighted Price Target Price: \$33.27 | Implied Upside: 38.3%

# Business Overview

Founded in 2002, Sprouts Farmers Market is a Phoenix-based grocery store with the mission of providing fresh produce at the heart of the store. Its products are targeted towards purpose-driven people that value organic, plant-based and gluten-free ingredients.

## Key Value Drivers

### Buyer Power

SFM sources fresh produce from hundreds of local suppliers, achieving flexible and decentralized purchasing that allows them to undercut its competitors on cost.

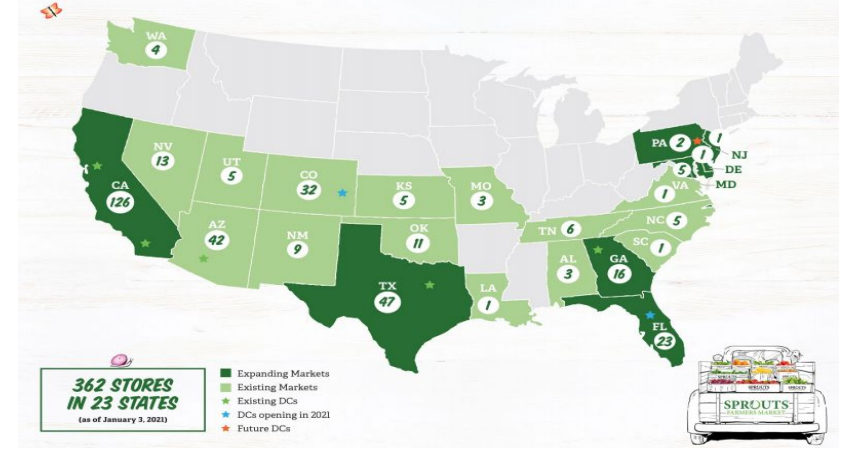
### Infrastructure Build

Two new distribution centers incoming through 2021 to help with store growth plans by having stores within 250 miles of DCs to optimize supply chain efficiencies.

### Expansion Whitespace

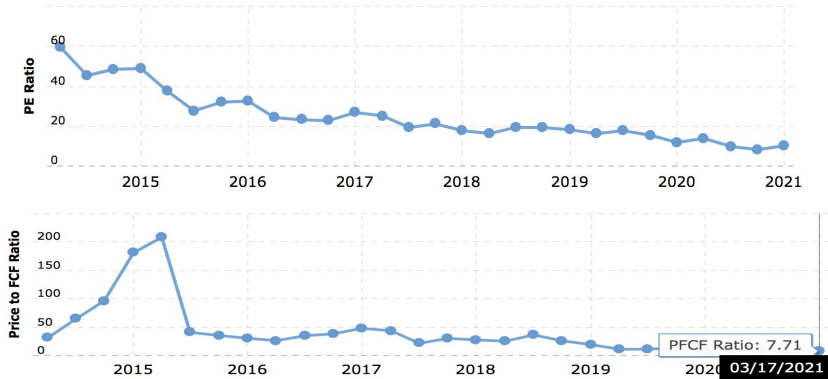
Currently in 23 states, the company aims to scale through at least 10% unit growth annually from 2022, and achieving cash on cash returns of 40% for new stores.

## Geographic Presence

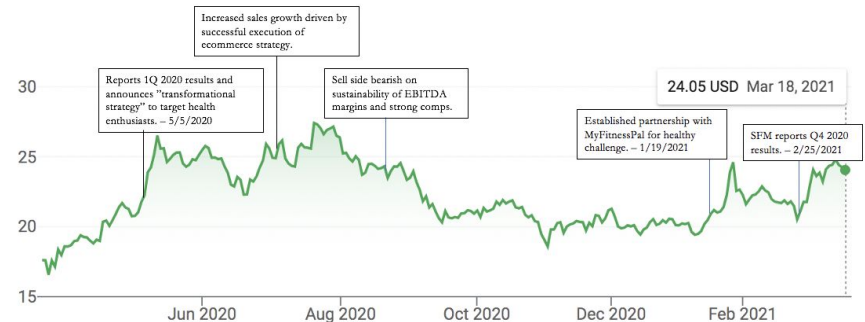


The store count is only 361 out of an estimated potential of 1,200 store count (30%). SFM has yet not yet fully expanded into the northern part of the U.S.

## Bearish Market Sentiment



## Stock Chart Analysis



# Industry Overview

Sprouts operates in the \$658B grocery store industry, specifically in the \$219B natural & organic sector growing @ 6-7% YoY.

## Industry Analysis using Porter's 5 Forces

**Threat of New Entrants (Low):** Need high capital to open supermarket, limited access to distribution channels & ability to competitively price w/o scale, difficult to differentiate offering & penetrate existing brand loyalty

**Threat of Substitutes (High):** Lots of substitute products, low switching costs, and hard to differentiate products bc mostly commodities/produce

**Bargaining Power of Suppliers (Low):** High # of growers, vendors, & food manufacturers and supermarkets can easily substitute products

**Bargaining Power of Buyers (High):** Low switching costs, high substitution ability, high price sensitivity, and high information availability

**Competitor Rivalry (High):** Large # of industry players, moderate levels of customer loyalty, moderate levels of differentiation b/w players & aggressive competition at each level, and low customer switching costs

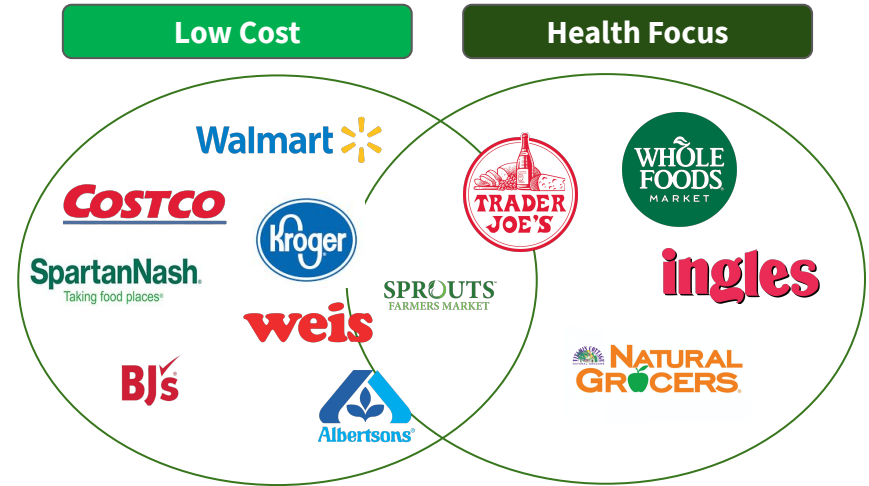
## Recent Trends

**Rising demand for natural & organic products:** More consumers than ever before (45% in 2019) are actively focused on making healthier dietary choices by seeking out natural & organic foods

**More robust eCommerce offerings:** COVID has accelerated the adoption and growth of grocery store eCommerce offerings (online grocery penetration is expected to reach b/w 51-57% in 2021)

**Accelerated rollout of premium & private-label products:** Retailers are increasingly planning to use store brands and premium items within their brands to differentiate their grocery selections and invite new and compelling products like meal solutions and kits (20% of sales growth in private label came from premium products in 2020)

## Competitive Landscape



## Sprouts' Economic Moat

**Brand Name-** notoriety for healthy products @ low prices, strong private label, unique products

**Cost Advantage-** decentralized buying structure w/ a diversified sourcing strategy = high negotiation power w/ suppliers

**Efficient Scale-** strategic distribution centers, more store density = lower marketing expense & increased brand awareness

# Investment Thesis Summary

The market is undervaluing SFM's expansion, private label, & digital business strategies.

|                       |   |
|-----------------------|---|
| <b>Thesis Point 1</b> | Sprouts' expansion to new geographic locations, especially in Florida, through smaller format stores will lead to higher ROI. Furthermore, its new distribution centers will result in major cost-cutting in transportation costs and increased flexibility in seasonal buying. |
| <b>Thesis Point 2</b> | SFM's private label product growth will lead to higher margins & increased customer loyalty.  |
| <b>Thesis Point 3</b> | Sprouts has been aggressively building its online community and e-commerce capabilities and transitioning to investing in higher-return digital ad campaigns.   |

|                         |   |
|-------------------------|---|
| <b>Information Edge</b> | 1) Search trend data (from Google Trends), 2) Independent cost cutting calculations (derived from data in 8K & 10K reports), and 3) Customer sentiment internet analysis (data from YT, Reddit, Instagram, FB, blogs) |
|-------------------------|---|

|                  |
|------------------|
| <b>Bear Case</b> |
| \$25.22          |
| 4.8% upside      |

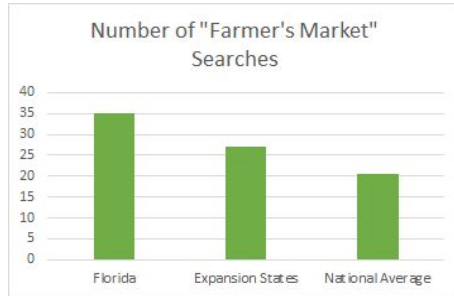
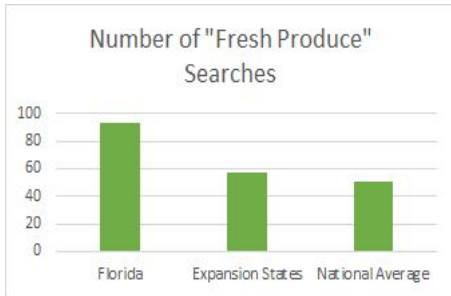
|                  |
|------------------|
| <b>Base Case</b> |
| \$34.95          |
| 45.03% upside    |

|                  |
|------------------|
| <b>Bull Case</b> |
| \$37.59          |
| 56.30% upside    |

# Thesis 1: Improved ROI and Cost Cutting

Sprouts' expansion to new geographic locations, especially in Florida, through smaller format stores will lead to higher ROI.

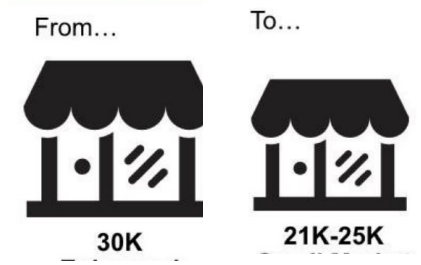
## Sprouts is expanding in the ripest market



- Sprouts is opening 20 new stores in 2021, 10 of which will be located in Florida.
- Our analysis of Google Trends data shows that most searches related to Sprout's products such as "fresh produce" or "Farmer's Market" correlate with states where Sprouts is expanding.

## Sprouts will cut major costs with new small stores

- Sprouts is returning to small box stores of 21K-25K square feet for its new stores.
- The new smaller sized stores are expected to have similar revenue while cutting



build-up costs from \$4m to \$3.2 m. We predict that this will result in a 20% reduction in the \$0.5m operating expenses per store due to the smaller store's less focus on deli and salad bars. Sprouts' new stores are expected to yield 40% cash on cash returns over 4 years. This shift will increase the profitability and productivity of stores.

## Larger Florida market from competitors' bankruptcies in Florida

Lucky's Market

- In 2020, major competitors Lucky's Market and Earth Fare announced the closure of their stores in Florida (20 of 21 Lucky's Market stores and all Earth Fare stores).

- Sprouts has the better unique private label products, track record, and financial health to expand in Florida. With these two speciality grocers exiting Florida, Sprouts will be able to capture a larger share of the less saturated market.

- Moreover these bankruptcies provide Sprouts with access to cheap real estate/discounted leases that fit their more profitable new, small box store design.

EARTH FARE

# Thesis 1: Improved ROI and Cost Cutting

Sprouts' new distribution centers will result in major cost-cutting in transportation costs and increase flexibility in seasonal buying.

## Reductions in Transportation Costs

- In 2021, Sprouts is opening 2 new distribution centers in Aurora, Colorado and Orlando, Florida which will create a supply chain within 250 miles of the majority of stores.
- Based on estimations that Sprouts will reduce nearly 3000 metric tons of carbon emissions, we calculated that Sprouts will save \$33,745,382.85 on transportation costs.

Estimated CO<sub>2</sub> emissions reductions: ~3000 metric tons  
 Average Freight Truck Capacity: 20,000 lbs / 2,000 lbs = 10 short tons  
 Average freight truck emission rate: 161.8 grams of CO<sub>2</sub> per ton-mile

Amount of Saved Miles : 3000 metric tons x 1,000,000 grams ÷ 161.8 CO<sub>2</sub> g/ton-mile ÷ 10 tons  
 Amount of Saved Miles = 18541419.1471 miles  
 Saved Costs: 18541419.1471 miles x \$1.82/mile = \$33,745,382.85

## Lower Costs of Produce Procurement

- The new distribution centers will also enable more local and seasonal buying. Purchasing produce from small, local farmers will give Sprouts greater bargaining power and reduce costs. At the same time, their expansion will enable them to use the economies of scale of their centralized buying team to procure large quantities of specific produce categories at cheaper prices.



## Additional Cost-Saving DC in 2022

| <b>VEHICLE-BASED</b>                     |                |
|--|----------------|
| Fuel costs                               | \$0.433        |
| Truck/trailer lease or purchase payments | \$0.265        |
| Repair & maintenance                     | \$0.171        |
| Truck insurance                          | \$0.084        |
| Permits/Licenses                         | \$0.024        |
| Tires                                    | \$0.038        |
| Tolls                                    | \$0.030        |
| <b>DRIVER-BASED</b>                      |                |
| Wages                                    | \$0.556        |
| Benefits                                 | \$0.180        |
| <b>Total</b>                             | <b>\$1.821</b> |

- Sprouts has plans to build a distribution center in Philadelphia in 2022. This DC would reduce distance between the Philadelphia store and a DC by 778 miles which we equate to 778 X 1.82= \$1416.74 in savings each way.
- Currently, the street is only taking the 2021 DCs into consideration. Pricing in the immense cost reduction from Sprouts strategic DC expansion now will result in a significant upside.

(Source: American Transportation Research Institute)






# Thesis 2: Private Label Product Growth

SFM's private label product growth will lead to higher margins & increased customer loyalty.

## Sprouts' Strategy & Private Label Growth




- Private label product lines accounted for 16% of total revenue in FY 2020 and are projected to generate ~20% of total revenue over the next few years
- Diversity of private label products has also been increasing with the collection growing by ~25% from last year's selection
- Private label products tend to be higher margin than SFM's other goods and also work to foster higher customer loyalty as can be seen with the success of Trader Joe's private label line because...
  - 1) Selling store brand goods does not require traditional slotting, marketing, and middleman fees that are needed to stock national brands
  - 2) Customers have to come to your store for your store brand products driving foot traffic especially when they perceive that your store brand sells quality & unique products
- SFM has hired Doug Rauch, a former Trader Joe's executive, to their Board of directors to help guide their private label strategy as they aspire to become a "health focused" Trader Joe's
- SFM already has an above industry average customer loyalty with a +65 net promoter score compared to the average +51 and following TJ's footsteps with private label can help put them over the top
- This is an optimal time to double down on private label as the pandemic driven recession drives more people to sample private label products and consumer sentiment remains favorable (80% of shoppers believe private label is as good /better than national brands)

sprouts  [Follow](#)    
2,471 posts 278k followers 6,293 following



## TRADER JOE'S® Case Study

- Trader Joe's has one of the industry's highest sales/sq foot & has the best in-class private label products & fierce customer loyalty
- Similar to Sprouts, Trader Joe's also...
  - 1) Has no regular promotions and employs EDLR
  - 2) Has a smaller store format
  - 3) Employs managed store growth to avoid cannibalization
  - 4) Utilizes SKU Optimization
  - 5) Innovates their products consistently by finding niche specialty products other brands don't make and creating them with their own private label
- What is Sprouts doing to further replicate Trader Joe's success?
  - 1) Cutting back on traditional commodity price promotions & loss leaders
  - 2) Putting an emphasis on display & presentation and promoting a discovery driven treasure hunt experience
  - 3) Offering free samples
  - 4) Paring down prepared food & dairy offerings
  - 5) Bolstering their private label strategy
  - 6) Focusing on selling a unique assortment of products that can't be found at other conventional supermarkets
  - 7) Closely identifying and aligning with their target customer
  - 8) Amplifying their fresh produce heritage (staying true to roots)
  - 9) Addressing product waste and shrink with better inventory management and other capability improvements

traderjoes  [Follow](#)    
1,130 posts 2.5m followers 0 following



# Thesis 3: Dedication to Digital Transformation

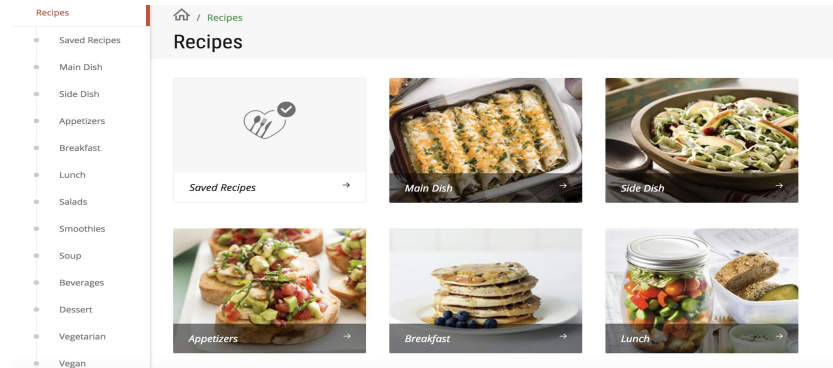
Sprouts has been aggressively building its online community and e-commerce capabilities, and transitioning to a higher ROI digital ad spending.

## Health Enthusiast Community



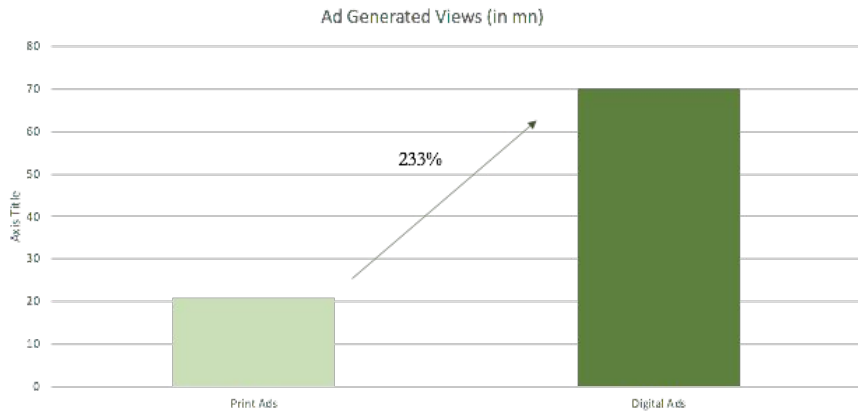
Featured on popular health enthusiast vloggers (>1.3 mn subscribers), Sprouts has a growing community of “health enthusiast” and “experience seeker” customers. Vloggers have filmed “Spouts Hauls” with views (289k), compared to Kroger hauls (70k), Publix hauls (74k), and Whole Food Hauls (229k).

## Online Recipes + One Click Shopping



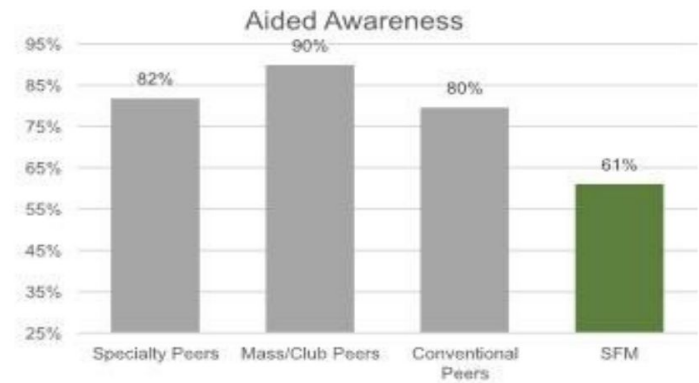
Sprouts offers recipe blogs online with its ingredients listed with a one-click shopping option.

## Branding and Advertising



Confirmed ad generated views rose from 21 mn to 70 mn when SFM transitioned from printed flyers to digital ads.

## Robust E-Commerce Opportunity



Significant whitespace fo SFM to introduce target customers.



# Variant Perception

## Street View

- x Groceries can only enjoy a temporary boost from covid, and reopening will cause purchases to decrease.
- x Sprouts operates in an increasingly competitive grocery market where conventional grocers will begin to expand fresh offerings.
- x Pullback in promotional activity is unsustainable, which will result in comp and margin degradation.
- x SFM's growth will slow down and repositioning will take time, leading to decreasing comps in FY 21.

## Our View

- o Consumer eating habits have transitioned to fresher food products, a trend that is here to stay.
- o Sprouts unique branding and strengthening relationships with suppliers allows Sprouts to achieve economies of scale that conventional grocers can't replicate.
- o Routine promotional activity is no longer necessary as the company transitions to EDLP with new management team members coming from Walmart.
- o Currently operating in 23 states, SFM's plan to open 10% new stores every year in emerging markets and reduce store size will improve the company's ROIC and unit economics.

# Catalysts and Risks

## CATALYSTS

- Sprout's new, in-store innovation centers as well as its unique Online Recipe + One Click Shopping feature will grow its online customer base of health-focused innovation seekers with its frictionless consumer experience which will bolster consumer loyalty.
- The expertise of Sprouts' new management members will grow of its private label business and drive increased ROI by successful implementation of everyday low pricing strategies/fewer ads strategy.
- We expect Sprouts' redesigned small box stores to increase sales per square foot based on consumer surveys while driving down operating costs.

## RISKS

- Publix which has majority market share in Florida is also taking advantages of Earth Fare and Lucky Market's exit to purchase new real estate for expansion of stores that could compete with Sprouts' new stores.
- After seeing margin compression in 2019, it is uncertain whether management expectations of a 4.8% EBIT margin can be achieved in 2021, especially with the imminent threat of a minimum wage hike and the rising commodity costs across the industry
- SFM is decreasing print promotion and commodity driven promotional events in its stores when traffic has been negative, which may further discourage shoppers & hurt sales growth

# Valuation Summary

Driven by 10% annual store growth following 2021, a rise in sales per square foot, and COGS deleveraging due to DCs and improved supply chain management, we value SFM at **\$33.27** with an **implied upside of 38.3%** (Last close 3/18/21: \$24.05)

## Methodology & Assumptions

- Our revenue build was based off the performance of new and old stores using sales per square foot as a performance indicator for the new smaller box stores and SSS as a driver for older stores.
- To model SSS and the new store schedule, we backed out historical rates from reported KPIs and used the 2018-2020 store schedules to estimate the proportion of stores opened each quarter.
- Major assumptions in our cost build included gradually deleveraging COGS a total of 200 bps by 2023 due to DCs, shrink reduction initiatives, and improved produce sourcing.

## Cases & Price Targets

| Case                              | Base    | Bear    | Bull    |
|-----------------------------------|---------|---------|---------|
| 22-23 Store Count Growth          | 10%     | 7%      | 12%     |
| Comparable Store Sales            | 3%      | 1.50%   | 4%      |
| COGS as a % of Revenue            | 63.6%   | 64.5%   | 63.0%   |
| Implied Price                     | \$34.95 | \$25.22 | \$37.59 |
| Implied Upside                    | 45.3%   | 4.9%    | 56.3%   |
| Probability                       | 70%     | 20%     | 10%     |
| Probability-Weighted Price Target | \$33.27 |         |         |
| Implied Upside                    | 38.3%   |         |         |

## Sensitivity Analysis

### Sensitivity Analysis

|          |      | WACC     |          |          |          |          |       |
|----------|------|----------|----------|----------|----------|----------|-------|
|          |      | \$34.95  | 4.67%    | 5.17%    | 5.67%    | 6.17%    | 6.67% |
| EBITDA x | 9.2  | \$ 32.15 | \$ 31.56 | \$ 30.99 | \$ 30.43 | \$ 29.88 |       |
|          | 9.7  | \$ 34.18 | \$ 33.57 | \$ 32.97 | \$ 32.38 | \$ 31.80 |       |
|          | 10.2 | \$ 36.22 | \$ 35.58 | \$ 34.95 | \$ 34.33 | \$ 33.73 |       |
|          | 10.7 | \$ 38.26 | \$ 37.59 | \$ 36.93 | \$ 36.28 | \$ 35.65 |       |
|          | 11.2 | \$ 40.29 | \$ 39.59 | \$ 38.91 | \$ 38.24 | \$ 37.58 |       |

|          |       | WACC     |          |          |          |          |  |
|----------|-------|----------|----------|----------|----------|----------|--|
|          |       | \$37.27  | 5.13%    | 5.63%    | 6.17%    | 6.67%    |  |
| Growth % | 1.50% | \$ 38.24 | \$ 32.37 | \$ 31.96 | \$ 27.43 | \$ 23.79 |  |
|          | 1.75% | \$ 41.58 | \$ 34.90 | \$ 34.44 | \$ 29.38 | \$ 25.35 |  |
|          | 2.00% | \$ 45.46 | \$ 37.78 | \$ 37.26 | \$ 31.56 | \$ 27.09 |  |
|          | 2.25% | \$ 50.00 | \$ 41.09 | \$ 40.49 | \$ 34.02 | \$ 29.01 |  |
|          | 2.50% | \$ 55.42 | \$ 44.93 | \$ 44.24 | \$ 36.82 | \$ 31.18 |  |

## Our Estimates vs Consensus

(Data from Bloomberg Terminal)

| Estimates vs. Cons. (\$mn)  | FY2021   | FY2022   | FY2023   |
|-----------------------------|----------|----------|----------|
| Revenue                     | \$ 5,932 | \$ 7,198 | \$ 7,314 |
| Consensus Revenue           | \$ 6,459 | \$ 6,995 | \$ 7,601 |
| Δ % Revenue                 | -8.16%   | 2.91%    | -3.77%   |
| EPS                         | \$ 1.91  | \$ 2.34  | \$ 2.49  |
| Consensus EPS               | \$ 1.86  | \$ 2.05  | \$ 2.40  |
| Δ % EPS                     | 2.95%    | 13.91%   | 3.85%    |
| EBITDA                      | \$ 438   | \$ 528   | \$ 551   |
| Consensus EBITDA            | \$ 442   | \$ 470   | \$ 521   |
| Δ % EBITDA                  | -0.82%   | 12.24%   | 5.71%    |
| Gross Margin                | 35.39%   | 36.24%   | 36.34%   |
| Consensus Gross Margin      | 35.80%   | 35.56%   | 35.85%   |
| Δ % Gross Margin            | -1.15%   | 1.89%    | 1.36%    |
| New Stores Opened           | 20       | 38       | 42       |
| Consensus New Stores Opened | 21       | 35       | 38       |
| Δ % New Stores Opened       | -4.76%   | 9.14%    | 10.58%   |
| SSS                         | -2.05%   | 2.75%    | 2.88%    |
| Consensus SSS               | -2.14%   | 2.29%    | 2.88%    |
| Δ % SSS                     | -4.31%   | 19.94%   | -0.15%   |

# Appendix: Management & Culture

## Key Management



**Jack Sinclair -- CEO** (since June 2019)

- 35+ years of retail/grocery experience – recent CEO of 99 Cents Only Stores and previously Executive VP of Grocery Division of Walmart
- “Jack is a proven CEO with an outstanding track record in grocery and retail merchandising.” - **Jack Fortunato (Chairman)**



**Scott Neal -- Chief Fresh Merchandising Officer**  
(since June 2020)

- 25+ years of retail experience – Senior vice president and general merchandise manager for the fresh food division of Walmart U.S

**Recent Departures:** Ex-CEO Amina Meredia (2018), Ex-CFO Brad Lukow (2019), Ex-COO Jim Nielsen (2020)

## Advantages

- Sprouts has been shifting to a balance of **everyday accessible pricing** and fewer ads, a strategy perfected by **Walmart** where their key management previously held positions.
- Sprouts **new Chief Marketing Officer** Gilliam Phipps is a **former Kroger private label specialist**. His expertise will be invaluable to Sprouts private label expansion strategy.
- Sprouts executives receive **performance-based cash bonuses** which incentivizes their commitment to the country's growth.
- About 40-50% of their **salary bonus is based on reaching Adjusted EBITDA** and comparable store sales growth benchmarks, which makes achieving operational efficiency in their best interest. There has also been **recent insider purchasing activity**.

## Culture

- “It's not about coming in as a cashier and staying as a cashier. It's also promoting people into higher-paying roles as well. in 2020, we promoted about 7,200 team members and we filled 72% of our store manager positions with internal candidates and we're really proud of that.” - **Denise Paulonis (CFO)**
- “Our commitment to friendly service doesn't stop at our stores. We pledge to be a good neighbor in every community we serve through volunteer work and local event support.” - **Company Website**
- “Sprouts prides itself on being a green company. We compost our produce. We don't just dump waste . I worked at Kroger for a while but I couldn't handle all the waste...Sprouts donates weekly to the poor be it foods or soaps and shampoos.” - **Sprouts Employee, Fort Worth Texas**

# Appendix: Revenue Build - Store Schedule (in ks)

| x | Sprouts Store Count Model                         | 1Q 2018A     | 2Q 2018A     | 3Q 2018A     | 4Q 2018A     | FY 2018A     | 1Q 2019A     | 2Q 2019A     | 3Q 2019A     | 4Q 2019A     | FY 2019A     | 1Q 2020A     | 2Q 2020A     | 3Q 2020A     | 4Q 2020A     | FY 2020A     |
|---|---|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
|   | Total Number of Stores                            | 294          | 301          | 313          | 313          | 313          | 321          | 326          | 335          | 340          | 340          | 344          | 350          | 356          | 362          | 362          |
|   | QoQ Add   | 9            | 7            | 12           | 7            | 28           | 8            | 5            | 9            | 5            | 27           | 4            | 6            | 6            | 6            | 22           |
|   | YOY Store Growth %                                |              |              |              |              |              | 9%           | 8%           | 7%           | 9%           | 9%           | 7%           | 7%           | 6%           | 6%           | 6%           |
|   | Number of Comparable Stores                       | 261          | 274          | 282          | 285          | 285          | 294          | 301          | 313          | 313          | 313          | 321          | 326          | 335          | 340          | 340          |
|   | Number of Non-Comparable Stores                   | 42           | 27           | 31           | 35           | 56           | 27           | 25           | 22           | 32           | 54           | 23           | 24           | 21           | 22           | 38           |
|   | Number of Stores that Become Comparable Next Year | 33           | 20           | 19           | 28           | 28           | 19           | 20           | 13           | 27           | 27           | 19           | 18           | 15           | 16           | 16           |
|   | Total 1Y+ Store Square Feet (Thousands)           | 7530         | 7905         | 8135         | 8222         | 8222         | 8514         | 8717         | 9064         | 9064         | 9064         | 9321         | 9466         | 9728         | 9873         | 9873         |
|   | Total <1Y Store Square Feet (Thousands)           | 1212         | 779          | 894          | 1010         | 1616         | 782          | 724          | 637          | 927          | 1564         | 668          | 697          | 610          | 639          | 1103         |
|   | Total Store Square Feet                           | 8741         | 8684         | 9030         | 9232         | 9838         | 9296         | 9441         | 9701         | 9991         | 10628        | 9989         | 10163        | 10338        | 10512        | 10976        |
|   | Total 1Y+ Store Sales Contribution                | \$ 1,145,604 | \$ 1,163,090 | \$ 1,196,198 | \$ 1,129,711 | \$ 4,634,529 | \$ 1,286,637 | \$ 1,302,477 | \$ 1,310,602 | \$ 1,242,141 | \$ 5,127,700 | \$ 1,547,747 | \$ 1,527,793 | \$ 1,467,166 | \$ 1,473,687 | \$ 5,951,258 |
|   | Total <1Y Store Sales Contribution                | \$ 141,592   | \$ 158,603   | \$ 132,911   | \$ 139,627   | \$ 572,807   | \$ 127,250   | \$ 113,259   | \$ 129,620   | \$ 122,849   | \$ 507,135   | \$ 98,792    | \$ 114,995   | \$ 110,432   | \$ 128,147   | \$ 517,501   |
|   | Net Sales per Square Foot (1Y+)                   | 152          | 147          | 147          | 137          | 564          | 151          | 149          | 145          | 137          | 566          | 166          | 161          | 151          | 149          | 603          |
|   | Net Sales per Square Foot (<1Y)                   | 117          | 204          | 149          | 138          | 355          | 163          | 156          | 203          | 133          | 324          | 148          | 165          | 181          | 201          | 469          |
|   | Average Store Square Ft                           | 28849        | 28849        | 28849        | 28849        | 28849        | 28959        | 28959        | 28959        | 28959        | 28959        | 29038        | 29038        | 29038        | 29038        | 29038        |
|   | Net Sales per Square Foot                         | \$ 147.25    | \$ 152.21    | \$ 147.19    | \$ 137.50    | \$ 529.33    | \$ 152.10    | \$ 149.96    | \$ 148.46    | \$ 136.62    | \$ 530.19    | \$ 164.83    | \$ 161.64    | \$ 152.61    | \$ 152.39    | \$ 589.34    |
|   | SpSF Growth %                                     | 1.6%         | 3.4%         | -3.3%        | -6.6%        | -6.6%        | 10.6%        | -1.40%       | -1.00%       | -7.97%       | -7.97%       | 20.6%        | -1.9%        | -5.6%        | -0.1%        | -0.1%        |
|   | Net Sales per 1Y+ Store                           | \$ 4,389     | \$ 4,245     | \$ 4,242     | \$ 3,964     | \$ 16,262    | \$ 4,376     | \$ 4,327     | \$ 4,187     | \$ 3,969     | \$ 16,382    | \$ 4,822     | \$ 4,686     | \$ 4,380     | \$ 4,334     | \$ 17,504    |
|   | Net Sales per <1Y Store                           | \$ 3,371     | \$ 5,874     | \$ 4,287     | \$ 3,989     | \$ 10,229    | \$ 4,713     | \$ 4,530     | \$ 5,892     | \$ 3,839     | \$ 9,391     | \$ 4,295     | \$ 4,791     | \$ 5,259     | \$ 5,825     | \$ 13,618    |

# Revenue Build - Store Schedule (Pro Forma)

| x | Sprouts Store Count Model                         | 1Q 2021E | 2Q 2021E | 3Q 2021E | 4Q 2021E | FY 2021E | 1Q 2022E | 2Q 2022E | 3Q 2022E | 4Q 2022E | FY 2022E | 1Q 2023E | 2Q 2023E | 3Q 2023E | 4Q 2023E | FY 2023E |
|---|---|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
|   | Total Number of Stores                            | 366      | 370      | 377      | 382      | 382      | 391      | 400      | 412      | 420      | 420      | 430      | 440      | 453      | 462      | 462      |
|   | QoQ Add   | 4        | 4        | 7        | 5        | 20       | 9        | 9        | 12       | 8        | 38       | 10       | 10       | 13       | 9        | 42       |
|   | YOY Store Growth %                                | 6%       | 6%       | 6%       | 6%       | 6%       | 7%       | 8%       | 9%       | 10%      | 10%      | 10%      | 10%      | 10%      | 10%      | 10%      |
|   | Number of Comparable Stores                       | 344      | 350      | 356      | 362      | 362      | 366      | 370      | 377      | 382      | 382      | 391      | 400      | 412      | 420      | 420      |
|   | Number of Non-Comparable Stores                   | 22       | 20       | 21       | 20       | 20       | 25       | 30       | 35       | 38       | 38       | 39       | 40       | 41       | 42       | 42       |
|   | Number of Stores that Become Comparable Next Year | 18       | 16       | 14       | 15       | 15       | 16       | 21       | 23       | 30       | 30       | 29       | 30       | 28       | 33       | 33       |





# Appendix: Revenue Build - New Store Square Feet Waterfall

| x | New Square Feet Waterfall (Years)        | 211Q  | 212Q  | 213Q  | 214Q  | 221Q  | 222Q  | 223Q  | 224Q  | 231Q  | 232Q  | 233Q  | 234Q  |
|---|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|   | 0.25                                     | 207   | 161   | 276   | 161   | 184   | 115   | 207   | 115   | 92    | 138   | 138   | 138   |
|   | 0.5                                      |       | 207   | 161   | 276   | 161   | 184   | 115   | 207   | 115   | 92    | 138   | 138   |
|   | 0.75                                     |       |       | 207   | 161   | 276   | 161   | 184   | 115   | 207   | 115   | 92    | 138   |
|   | 1  |       |       |       | 207   | 161   | 276   | 161   | 184   | 115   | 207   | 115   | 92    |
|   | 1.25                                     |       |       |       |       | 207   | 161   | 276   | 161   | 184   | 115   | 207   | 115   |
|   | 1.5                                      |       |       |       |       |       | 207   | 161   | 276   | 161   | 184   | 115   | 207   |
|   | 1.75                                     |       |       |       |       |       |       | 207   | 161   | 276   | 161   | 184   | 115   |
|   | 2  |       |       |       |       |       |       |       | 207   | 161   | 276   | 161   | 184   |
|   | 2.25                                     |       |       |       |       |       |       |       |       | 207   | 161   | 276   | 161   |
|   | 2.5                                      |       |       |       |       |       |       |       |       |       | 207   | 161   | 276   |
|   | 2.75                                     |       |       |       |       |       |       |       |       |       |       | 207   | 161   |
|   | 3  |       |       |       |       |       |       |       |       |       |       |       | 207   |
|   | Total New Square Feet (in Thousands)     | 207   | 368   | 644   | 805   | 989   | 1104  | 1311  | 1426  | 1518  | 1656  | 1794  | 1932  |
|   | Total Sprouts Square Feet (in Thousands) | 10719 | 11087 | 11731 | 12536 | 13525 | 14629 | 15940 | 17366 | 18884 | 20540 | 22334 | 24266 |
|   | % New Square Feet                        | 1.93% | 3.32% | 5.49% | 6.42% | 7.31% | 7.55% | 8.22% | 8.21% | 8.04% | 8.06% | 8.03% | 7.96% |

# Appendix: Revenue Build - New Store/Small Box Revenue (in ks)

| x    | Small Box Revenue Waterfall    | 211Q            | 212Q            | 213Q             | 214Q             | 221Q             | 222Q             | 223Q             | 224Q             | 231Q             | 232Q             | 233Q             | 234Q             |
|------|--------------------------------|-----------------|-----------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| 0.25 |                                | \$41,400        | \$32,200        | \$55,200         | \$32,200         | \$36,800         | \$524,635        | \$41,400         | \$23,000         | \$18,400         | \$27,600         | \$27,600         | \$27,600         |
| 0.5  |                                | \$41,400        | \$41,400        | \$32,200         | \$55,200         | \$32,200         | \$36,800         | \$23,000         | \$41,400         | \$23,000         | \$18,400         | \$27,600         | \$27,600         |
| 0.75 |                                |                 |                 | \$41,400         | \$32,200         | \$55,200         | \$32,200         | \$36,800         | \$23,000         | \$41,400         | \$23,000         | \$18,400         | \$27,600         |
| 1    |                                |                 |                 |                  | \$41,400         | \$32,200         | \$55,200         | \$32,200         | \$36,800         | \$23,000         | \$41,400         | \$23,000         | \$19,320         |
| 1.25 |                                |                 |                 |                  |                  | \$43,470         | \$33,810         | \$57,960         | \$33,810         | \$38,640         | \$24,150         | \$43,470         | \$24,150         |
| 1.5  |                                |                 |                 |                  |                  |                  | \$43,470         | \$33,810         | \$57,960         | \$33,810         | \$38,640         | \$24,150         | \$43,470         |
| 1.75 |                                |                 |                 |                  |                  |                  |                  | \$43,470         | \$33,810         | \$57,960         | \$33,810         | \$38,640         | \$24,150         |
| 2    |                                |                 |                 |                  |                  |                  |                  |                  | \$43,470         | \$33,810         | \$57,960         | \$33,810         | \$38,640         |
| 2.25 |                                |                 |                 |                  |                  |                  |                  |                  |                  | \$43,470         | \$33,810         | \$57,960         | \$33,810         |
| 2.5  |                                |                 |                 |                  |                  |                  |                  |                  |                  |                  | \$43,470         | \$33,810         | \$57,960         |
| 2.75 |                                |                 |                 |                  |                  |                  |                  |                  |                  |                  |                  | \$43,470         | \$33,810         |
| 3    |                                |                 |                 |                  |                  |                  |                  |                  |                  |                  |                  |                  | \$43,470         |
|      | <b>Total Small Box Revenue</b> | <b>\$41,400</b> | <b>\$73,600</b> | <b>\$128,800</b> | <b>\$161,000</b> | <b>\$199,870</b> | <b>\$726,115</b> | <b>\$268,640</b> | <b>\$293,250</b> | <b>\$313,490</b> | <b>\$342,240</b> | <b>\$371,910</b> | <b>\$401,580</b> |

## Revenue Build - Total Revenue

| Year                    | 1Q 2018A     | 2Q 2018A     | 3Q 2018A     | 4Q 2018A     | FY 2018A     | 1Q 2019A     | 2Q 2019A     | 3Q 2019A     | 4Q 2019A     | FY 2019A     | 1Q 2020A     | 2Q 2020A     | 3Q 2020A     | 4Q 2020A     | FY 2020A     |
|-------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| x Sprouts Total Revenue | \$ 1,287,196 | \$ 1,321,693 | \$ 1,329,109 | \$ 1,269,338 | \$ 5,207,336 | \$ 1,413,887 | \$ 1,415,736 | \$ 1,440,222 | \$ 1,364,990 | \$ 5,634,835 | \$ 1,646,539 | \$ 1,642,788 | \$ 1,577,598 | \$ 1,601,834 | \$ 6,468,759 |
| Old Stores Revenue      | \$ 1,287,196 | \$ 1,321,693 | \$ 1,329,109 | \$ 1,269,338 | \$ 5,207,336 | \$ 1,413,887 | \$ 1,415,736 | \$ 1,440,222 | \$ 1,364,990 | \$ 5,634,835 | \$ 1,646,539 | \$ 1,642,788 | \$ 1,577,598 | \$ 1,601,834 | \$ 6,468,759 |
| SSS Growth (%)          | 2.70%        | 2.00%        | 1.50%        | 2.20%        | 2.10%        | 1.40%        | 0.10%        | 1.50%        | 1.40%        | 1.10%        | 10.60%       | 9.10%        | 4.20%        | 6.80%        | 6.90%        |
| New Stores Revenue      |              |              |              |              |              |              |              |              |              |              |              |              |              |              |              |
| Total Number of Stores  | 294          | 301          | 313          | 313          | 313          | 321          | 326          | 335          | 340          | 340          | 344          | 350          | 356          | 362          | 362          |
| Sales per Square Feet   | \$ 147.25    | \$ 152.21    | \$ 147.19    | \$ 137.50    | \$ 529.33    | \$ 152.10    | \$ 149.96    | \$ 148.46    | \$ 136.62    | \$ 530.19    | \$ 164.83    | \$ 161.64    | \$ 152.61    | \$ 152.39    | \$ 589.34    |

| Year                    | 1Q 2021E    | 2Q 2021E    | 3Q 2021E    | 4Q 2021E    | FY 2021E    | 1Q 2022E    | 2Q 2022E    | 3Q 2022E    | 4Q 2022E    | FY 2022E    | 1Q 2023E    | 2Q 2023E    | 3Q 2023E    | 4Q 2023E    | FY 2023E    |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| x Sprouts Total Revenue | \$1,398,449 | \$1,452,595 | \$1,501,630 | \$1,579,486 | \$5,932,161 | \$1,614,644 | \$2,115,454 | \$1,697,110 | \$1,771,171 | \$7,198,379 | \$1,759,945 | \$1,813,824 | \$1,826,437 | \$1,913,885 | \$7,314,091 |
| Old Stores Revenue      | \$1,547,747 | \$1,577,076 | \$1,577,598 | \$1,633,871 | \$6,336,292 | \$1,594,179 | \$1,624,389 | \$1,617,038 | \$1,674,717 | \$6,510,323 | \$1,642,004 | \$1,673,120 | \$1,657,464 | \$1,724,959 | \$6,697,548 |
| SSS Growth (%)          | -6.00%      | -4.00%      | 0.00%       | 2.00%       | -2.05%      | 3.00%       | 3.00%       | 2.50%       | 2.50%       | 2.75%       | 3.00%       | 3.00%       | 2.50%       | 3.00%       | 2.88%       |
| New Stores Revenue      | \$41,400    | \$73,600    | \$128,800   | \$161,000   | \$404,800   | \$199,870   | \$726,115   | \$268,640   | \$293,250   | \$1,487,875 | \$313,490   | \$342,240   | \$371,910   | \$401,580   | \$1,429,220 |
| Total Number of Stores  | 366         | 370         | 377         | 382         | 382         | 391         | 400         | 412         | 420         | 420         | 430         | 440         | 453         | 462         | 462         |
| Sales per Square Feet   | \$130       | \$131       | \$128       | \$126       | \$515       | \$119       | \$145       | \$106       | \$102       | \$472       | \$93        | \$88        | \$82        | \$79        | \$342       |

## Appendix: Cost Build (in ks)

|                             | 1Q 2018A  | 2Q 2018A  | 3Q 2018A  | 4Q 2018A  | FY 2018A    | 1Q 2019A  | 2Q 2019A  | 3Q 2019A  | 4Q 2019A  | FY 2019A    | 1Q 2020A    | 2Q 2020A    | 3Q 2020A  | 4Q 2020A    | FY 2020A    |
|-----------------------------|-----------|-----------|-----------|-----------|-------------|-----------|-----------|-----------|-----------|-------------|-------------|-------------|-----------|-------------|-------------|
| <i>(in thousands)</i>       |           |           |           |           |             |           |           |           |           |             |             |             |           |             |             |
| X Sprouts Cost Drivers      |           |           |           |           |             |           |           |           |           |             |             |             |           |             |             |
| COGS/Revenue                | 69.9%     | 71.2%     | 71.2%     | 52.9%     | 66.4%       | 65.7%     | 67.2%     | 66.9%     | 65.6%     | 66.4%       | 63.9%       | 62.7%       | 62.9%     | 63.3%       | 63.2%       |
| % Change                    |           | 1.8%      | 0.0%      | -25.7%    | 25.6%       | -1.1%     | 2.2%      | -0.4%     | -1.9%     | 1.1%        | -3.7%       | -1.9%       | 0.4%      | 0.6%        | -0.1%       |
| Change in bps               |           | 12.87     | 0.13      | -183.13   | 135.25      | -6.99     | 14.27     | -2.71     | -12.56    | 7.30        | -24.39      | -12.28      | 2.27      | 3.57        | -0.71       |
| Cost of Goods Sold          | (900,144) | (941,281) | (946,734) | (671,702) | (3,459,861) | (929,538) | (950,954) | (963,497) | (896,028) | (3,740,017) | (1,052,707) | (1,030,129) | (992,829) | (1,013,805) | (4,089,470) |
| SG&A/Revenue                | 23.62%    | 23.94%    | 24.47%    | 36.14%    | 26.97%      | 26.51%    | 27.06%    | 28.07%    | 28.39%    | 27.50%      | 26.50%      | 29.76%      | 30.11%    | 28.94%      | 28.81%      |
| % Change                    |           | 1.4%      | 2.2%      | 47.7%     | -25.4%      | -1.7%     | 2.1%      | 3.7%      | 1.1%      | -3.1%       | -3.7%       | 12.3%       | 1.2%      | -3.9%       | -0.5%       |
| Change in bps               |           | 3.19      | 5.28      | 116.75    | -91.73      | -4.60     | 5.51      | 10.10     | 3.16      | -8.85       | -10.04      | 32.61       | 3.53      | -11.68      | -1.31       |
| SG&A Expense                | (304,042) | (316,410) | (325,209) | (458,782) | (1,404,443) | (374,826) | (383,116) | (404,285) | (387,480) | (1,549,707) | (436,304)   | (488,877)   | (475,053) | (463,635)   | (1,863,869) |
| X Sprouts SG&A Drivers      |           |           |           |           |             |           |           |           |           |             |             |             |           |             |             |
| Advertising Expense/Revenue | 0.97%     | 0.95%     | 0.94%     | 0.99%     | 0.96%       | 1.01%     | 1.01%     | 0.99%     | 1.05%     | 1.02%       | 0.83%       | 0.83%       | 0.86%     | 0.85%       | 0.84%       |
| Rent Expenses/Revenue       | 0.02%     | 0.02%     | 0.02%     | 0.02%     | 0.02%       | 0.02%     | 0.02%     | 0.02%     | 0.02%     | 0.02%       | 0.02%       | 0.02%       | 0.02%     | 0.02%       | 0.02%       |
| Remaining SG&A/Revenue      | 24.14%    | 23.51%    | 23.38%    | 24.48%    | 23.87%      | 24.18%    | 24.18%    | 24.18%    | 24.18%    | 24.18%      | 25.71%      | 25.71%      | 25.71%    | 25.71%      | 25.71%      |
| SG&A Ex Dep/Revenue         | 23.62%    | 23.94%    | 24.47%    | 25.49%    | 26.97%      | 26.51%    | 27.06%    | 28.07%    | 28.39%    | 27.50%      | 26.50%      | 29.76%      | 30.11%    | 28.94%      | 28.81%      |

## Cost Build (Pro Forma)

|                             | 1Q 2021E     | 2Q 2021E     | 3Q 2021E     | 4Q 2021E       | FY 2021E       | 1Q 2022E       | 2Q 2022E       | 3Q 2022E       | 4Q 2022E       | FY 2022E       | 1Q 2023E       | 2Q 2023E       | 3Q 2023E       | 4Q 2023E       | FY 2023E       |
|-----------------------------|--------------|--------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <i>(in thousands)</i>       |              |              |              |                |                |                |                |                |                |                |                |                |                |                |                |
| X Sprouts Cost Drivers      |              |              |              |                |                |                |                |                |                |                |                |                |                |                |                |
| COGS/Revenue                | 65.4%        | 64.9%        | 64.4%        | 63.9%          | 64.6%          | 63.76%         | 63.76%         | 63.76%         | 63.76%         | 63.76%         | 63.66%         | 63.66%         | 63.66%         | 63.66%         | 63.66%         |
| % Change                    | 3.4%         | -0.8%        | -0.8%        | -0.8%          | 1.2%           | -1.3%          | 0.0%           | 0.0%           | 0.0%           | 0.0%           | -0.2%          | 0.0%           | 0.0%           | 0.0%           | 0.0%           |
| Change in bps               | 21.45        | -5.00        | -5.00        | -5.00          | 7.50           | -8.50          | 0.00           | 0.00           | 0.00           | 0.00           | -1.00          | 0.00           | 0.00           | 0.00           | 0.00           |
| Cost of Goods Sold          | (914,083.97) | (942,213.21) | (966,511.14) | (1,008,725.01) | (3,833,013.69) | (1,029,563.69) | (1,348,900.57) | (1,082,147.41) | (1,129,371.47) | (4,589,983.14) | (1,120,453.55) | (1,154,755.40) | (1,162,784.79) | (1,218,458.15) | (4,656,451.89) |
| SG&A/Revenue                | 28.0%        | 28.0%        | 28.0%        | 28.0%          | 28.0%          | 28.9%          | 28.9%          | 28.9%          | 28.9%          | 28.9%          | 28.8%          | 28.8%          | 28.8%          | 28.8%          | 28.8%          |
| % Change                    | -2.8%        | 0.0%         | 0.0%         | 0.0%           | 0.0%           | 3.2%           | 0.0%           | 0.0%           | 0.0%           | 0.0%           | -0.3%          | 0.0%           | 0.0%           | 0.0%           | 0.0%           |
| Change in bps               | -8.13        | 0.00         | 0.00         | 0.00           | 0.00           | 9.00           | 0.00           | 0.00           | 0.00           | 0.00           | -1.00          | 0.00           | 0.00           | 0.00           | 0.00           |
| SG&A Expense                | (391,565.74) | (406,726.68) | (420,456.47) | (442,256.14)   | (1,661,005.02) | (466,632.16)   | (611,366.15)   | (490,464.83)   | (511,868.33)   | (2,080,331.48) | (506,864.16)   | (522,381.43)   | (526,013.71)   | (551,198.90)   | (2,106,458.20) |
| X Sprouts SG&A Drivers      |              |              |              |                |                |                |                |                |                |                |                |                |                |                |                |
| Advertising Expense/Revenue | 0.85%        | 0.85%        | 0.85%        | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          | 0.85%          |
| Rent Expenses/Revenue       | 0.02%        | 0.02%        | 0.02%        | 0.02%          | 0.02%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          | 0.01%          |
| Remaining SG&A/Revenue      | 25.90%       | 25.90%       | 25.90%       | 25.90%         | 25.90%         | 26.00%         | 26.00%         | 26.00%         | 26.00%         | 26.00%         | 26.10%         | 26.10%         | 26.10%         | 26.10%         | 26.10%         |
| SG&A Ex Dep/Revenue         | 28.0%        | 28.0%        | 28.0%        | 28.0%          | 28.0%          | 28.9%          | 28.9%          | 28.9%          | 28.9%          | 28.9%          | 28.8%          | 28.8%          | 28.8%          | 28.8%          | 28.8%          |

# Appendix: NWC Schedule (in ks)

| (in thousands)  | 2018 A            | 2019 A         | 2020 A         | 2021 E             | 2022 E             | 2023 E             |
|---|-------------------|----------------|----------------|--------------------|--------------------|--------------------|
| <b>Memo:</b>  |                   |                |                |                    |                    |                    |
| Sales   | \$ 5,207,336      | \$ 5,634,835   | \$ 6,468,759   | \$5,932,161        | \$7,198,379        | \$7,314,091        |
| COGS  | 3,459,861         | 3,740,017      | 4,089,470      | 3,833,013.69       | 4,589,983.14       | 4,656,451.89       |
| <b>Key Assumptions</b>                                      |                   |                |                |                    |                    |                    |
| Days Sales Outstanding (DSO)                                | 2.8               | 1.0            | 9.6            | 4.5                | 5.0                | 6.4                |
| Days Inventory Held (DIH)                                   | 27.9              | 26.9           | 1.3            | 18.7               | 15.7               | 11.9               |
| Days Payable Outstanding (DPO)                              | <u>12.7</u>       | <u>12.0</u>    | <u>12.4</u>    | <u>12.4</u>        | <u>12.3</u>        | <u>12.4</u>        |
| <b>Cash Conversion Cycle</b>                                | <u>18.0</u>       | <u>16.0</u>    | <u>-1.5</u>    | <u>10.8</u>        | <u>8.4</u>         | <u>5.9</u>         |
| Other Current Assets (% of Sales)                           | 0.52%             | 0.19%          | 3.93%          | 1.55%              | 1.89%              | 2.46%              |
| Accrued Expenses and Other Current Liabilities (% of Sales) | 5.27%             | 4.95%          | 5.38%          | 5.20%              | 5.18%              | 5.25%              |
| <b>Calculated NWC</b>                                       |                   |                |                |                    |                    |                    |
| Net Accounts Receivable                                     | 40,564            | 15,713         | 169,697        | \$72,791           | \$99,079           | \$127,431          |
| Inventory   | 264,366           | 275,979        | 14,815         | 196535.2064        | 196891.7471        | 151789.4839        |
| <u>Other Current Assets</u>                                 | <u>27,323</u>     | <u>10,833</u>  | <u>254,224</u> | <u>\$91,889</u>    | <u>\$136,080</u>   | <u>\$179,669</u>   |
| <b>Current Operating Assets</b>                             | 332,253           | 302,525        | 438,736        | \$361,215          | \$432,051          | \$458,890          |
| Accounts Payable  | 120,265.00        | 122,839        | 139,337        | 129909.4091        | 154237.0223        | 157647.8093        |
| <u>Accrued Expenses and Other Current Liabilities</u>       | <u>\$ 182,307</u> | <u>185,061</u> | <u>220,097</u> | <u>199308.7251</u> | <u>237607.6128</u> | <u>244595.4903</u> |
| <b>Current Operating Liabilities</b>                        | \$ 302,572        | \$ 307,900     | \$ 359,434     | 329218.1342        | 391844.6351        | 402243.2996        |
| <b>Net Working Capital (NWC)</b>                            | 29,681            | (5,375)        | 79,302         | \$31,997           | \$40,206           | \$56,646           |
| <b>(Increase) Decrease in NWC</b>                           |                   | (35,056)       | 84,677         | -\$47,305          | \$8,210            | \$16,440           |
| Capex   | (177,083)         | (183,232)      | (121,968)      | -\$136,440         | -\$179,959         | -\$219,423         |
| Capex (% of Revenue)  | -3.40%            | -3.25%         | -1.89%         | -2.3%              | -2.5%              | -3.0%              |



## Appendix: DCF Build (in mns)

### Discounted Cash Flow Analysis

| (in mn)               | 2020             | 2021E            | 2022E            | 2023E            |
|-----------------------|------------------|------------------|------------------|------------------|
| Sales (net)           | 6,468.76         | 5,932.16         | 7,198.38         | 7,314.09         |
| <u>COGS</u>           | <u>-4,089.47</u> | <u>-3,833.01</u> | <u>-4,589.98</u> | <u>-4,656.45</u> |
| <b>Gross Profit</b>   | 2,379.29         | 2,099.15         | 2,608.40         | 2,657.64         |
| <u>SG&amp;A</u>       | <u>-1,863.50</u> | <u>-1,661.16</u> | <u>-2,080.48</u> | <u>-2,106.61</u> |
| <b>EBITDA</b>         | 515.79           | 437.99           | 527.91           | 551.03           |
| <u>D&amp;A</u>        | <u>-124.12</u>   | <u>-118.64</u>   | <u>-140.37</u>   | <u>-138.97</u>   |
| <b>EBIT</b>           | 391.67           | 319.35           | 387.55           | 412.06           |
| <u>Taxes on EBIT</u>  | <u>-96.35</u>    | <u>-78.56</u>    | <u>-95.34</u>    | <u>-101.37</u>   |
| <b>NOPAT</b>          | 295.32           | 240.79           | 292.21           | 310.70           |
| D&A                   |                  | 118.64           | 140.37           | 138.97           |
| (-)Increase in WCR    |                  | 47.31            | -8.21            | -16.44           |
| (-)CapEx              |                  | <u>-136.44</u>   | <u>-179.96</u>   | <u>-219.42</u>   |
| <b>Free Cash Flow</b> |                  | 270.30           | 244.41           | 213.80           |

| Perpetuity Multiple Approach         |               |
|--------------------------------------|---------------|
| Present Value of Forecast Period FCF | 656           |
| Terminal Year Unlevered FCF          | 214           |
| <u>Perpetuity Growth Rate</u>        | <u>2%</u>     |
| Terminal Value                       | 5,944         |
| <u>PV Terminal Value</u>             | <u>5,038</u>  |
| <b>Enterprise Value</b>              | 5,693         |
| <u>Net Debt</u>                      | <u>-1,297</u> |
| <b>Equity Value</b>                  | 4,396         |
| Shares outstanding                   | 117.95        |
| <b>Value Per Share</b>               | \$37.27       |
| <b>Upside per share</b>              | 55%           |

| EBITDA Multiple Approach             |               |
|--------------------------------------|---------------|
| Present Value of Forecast Period FCF | 656           |
| Terminal Multiple                    | 10.2          |
| <u>PV of terminal Value</u>          | <u>4,764</u>  |
| <b>Enterprise Value</b>              | 5,419         |
| <u>(-)Net Debt</u>                   | <u>-1,297</u> |
| <b>Equity Value</b>                  | 4,122         |
| <u>Shares outstanding</u>            | <u>117.95</u> |
| <b>Value per share</b>               | \$34.95       |
| <b>Upside per share</b>              | 45%           |

## Appendix: Comps Table

| Ticker                   | Mkt Cap (USD) | EV     | EV/TTM EBITDA | EV/EBITDA FY1 | EV/EBITDA FY2 | P/E  | P/E FY1 | P/E FY2 | P/FCF |  |
|--------------------------|---------------|--------|---------------|---------------|---------------|------|---------|---------|-------|--|
| SFM US Equity            | 2837          | 4134   | 7.0           | 9.4           | 8.8           | 9.6  | 13.0    | 11.8    | 7.6   |  |
| <b>Direct Comp Set</b>   |               |        |               |               |               |      |         |         |       |  |
| Natural Grocers          | 361           | 730    | 7.1           | N/A           | N/A           | 15.6 | 24.2    | 21.3    | 7.3   |  |
| Ingles Markets           | 1233          | 1858   | 3.2           | N/A           | N/A           | 5.7  | N/A     | N/A     | 3.6   |  |
| Mean                     | 797           | 1294   | 5.2           | N/A           | N/A           | 10.7 | 24.2    | 21.3    | 5.5   |  |
| Median                   | 797           | 1294   | 5.2           | N/A           | N/A           | 10.7 | 24.2    | 21.3    | 5.5   |  |
| <b>Extended Comp Set</b> |               |        |               |               |               |      |         |         |       |  |
| Walmart                  | 24568         | 32791  | 9.8           | 11.9          | N/A           | 23.5 | 23.7    | 21.8    | 14.3  |  |
| Target                   | 367835        | 419573 | 10.3          | 11.1          | N/A           | 20.3 | 20.5    | 18.7    | 11.4  |  |
| BJ                       | 89556         | 96154  | 10.7          | 8.7           | N/A           | 15.3 | 15.4    | 13.9    | 8.5   |  |
| Costco                   | 5557          | 8740   | 18.7          | 17.4          | N/A           | 32.1 | 31.1    | 29.5    | 24.6  |  |
| Kroger                   | 26411         | 46627  | 6.9           | 7.6           | 7.5           | 10.1 | 12.4    | 12.1    | 6.9   |  |
| Grocery Outlet Holding   | 3373          | 4647   | 17.9          | 21.8          | 19.4          | 38.2 | 34.9    | 30.5    | 57.6  |  |
| Weis Markets             | 1519          | 1456   | 4.0           | N/A           | N/A           | 12.3 | N/A     | N/A     | 10.3  |  |
| Albertsons               | 8389          | 22785  | 5.0           | 5.2           | 6.8           | 6.2  | 5.7     | 9.4     | 4.6   |  |
| Mean                     | 65901         | 79097  | 10.4          | 11.9          | 11.2          | 19.7 | 20.5    | 19.4    | 17.3  |  |
| Median                   | 16478         | 27788  | 10.1          | 11.1          | 7.5           | 17.8 | 20.5    | 18.7    | 10.9  |  |
| Mean                     | 48331         | 58136  | 9.1           | 11.6          | 10.6          | 17.2 | 20.1    | 18.8    | 14.2  |  |
| Median                   | 5557          | 8740   | 7.1           | 10.2          | 8.2           | 15.3 | 20.5    | 18.7    | 8.5   |  |

# Sprouts Farmers Market

**Ticker:** SFM (NASDAQ)  
**Last Close:** \$24.01  
**FY 20 Revenue:** 6468.8 mn

**Enterprise Value:** 4133.7 mn  
**FY 2020 EBITDA:** 515.8 mn  
**Shares Outstanding:** 117.95 mn

**P/E:** 9.6x  
**EV/TTM EBITDA:** 7.0x  
**Market Capitalization:** 2736.7 mn

## **Business Overview**

Founded in 2002, Sprouts Farmers Market is a Phoenix-based grocery store with the mission of providing fresh produce at the heart of the store. Its products are targeted towards purpose-driven people that value organic, plant-based and gluten-free ingredients. Currently, Sprouts operates 363 stores in 23 states nationwide, and plans to open ~30 stores annually until it reaches the total targeted store account of 1,200 stores. Its future expansion strategy includes developing smaller stores for better unit economics, geographic store expansion from the southern states to the north, driving efficiencies in its fresh supply chain, and increasing its ecommerce presence.

## **Industry Overview**

SFM operates in the highly competitive and fragmented grocery store industry worth over \$658B, which includes large conventional independent and chain supermarkets, warehouse clubs, discount stores, and natural & organic and other specialty food retailers in both online and brick & mortar format. In particular, SFM is positioned in the \$219B natural & organic industry that has been growing at a rate of 6-7% annually. Rather than competing directly with other natural & organic food retailers, Sprouts believes in capturing market share from traditional independent and chain supermarkets. Within the grocery store industry, Sprouts directly competes with Whole Foods, Trader Joe's, Natural Grocers, and Ingles Markets and less directly with Walmart, Costco, Kroger, BJ's Wholesale Club, Weis Markets, Albertsons, Grocery Outlet, and SpartanNash. SFM successfully competes within the industry with its defensible economic moat consisting of valuable intangible assets, cost advantage, and efficient scale. The Sprouts brand is known for delivering high quality natural & healthy products at low prices and is only becoming stronger with the growth of its private label products. SFM also employs a diversified sourcing strategy and decentralized buying structure, which enables it to bargain strongly with local suppliers and offer some of the cheapest prices in the industry. As a greater density of SFM stores occupy a given region, marketing expenses drop and brand awareness increases.

**Investment Thesis: 1) Improved ROI and Cost Cutting:** Sprouts is opening 20 new stores in 2021, 10 of which will be located in Florida. Our analysis of Google Trends data shows that most searches related to Sprout's products such as "fresh produce" or "Farmer's Market" correlate with states where Sprouts is expanding. In 2020, major competitors Lucky's Market and Earth Fare announced the closure of their stores in Florida (20 of 21 Lucky's Market stores and all Earth Fare stores). Sprouts has the better unique private label products, track record, and financial health to expand in Florida. With these two speciality grocers exiting Florida, Sprouts will be able to capture a larger share of the less saturated market. Moreover these bankruptcies provide Sprouts with access to cheap real estate/discounted leases that fit their more profitable new, small box store design. Sprouts is returning to small box stores of 21K-25K square feet for its new stores. The new smaller sized stores are expected to have similar revenue while cutting build-up costs from \$4m to \$3.2 m. We predict that this will result in a 20% reduction in the \$0.5m operating expenses per store due to the smaller store's less focus on deli and salad bars. Sprouts' new stores are expected to yield 40% cash on cash returns over 4 years. This shift will increase the profitability and productivity of stores. Finally, Sprouts' new distribution centers will result in major cost-cutting in transportation costs and increase flexibility in seasonal buying. In 2021, Sprouts is opening 2 new distribution centers in Aurora, Colorado and Orlando, Florida which will create a supply chain within 250 miles of the majority of stores. Based on estimations that Sprouts will reduce nearly 3000 metric tons of carbon emissions, we calculated that Sprouts will save \$33,745,382.85 on transportation costs. Sprouts has plans to build a distribution center in Philadelphia in 2022. This DC would reduce distance between the Philadelphia store and a DC by 778 miles which we equate to  $778 \times 1.82 = \$1416.74$  in savings each way. Currently, the street is only taking the 2021 DCs into consideration. Pricing in the immense cost reduction from Sprouts strategic DC expansion now will result in a significant upside. The new distribution centers will also enable more local and seasonal buying. Purchasing produce from small, local farmers will give Sprouts greater bargaining power and reduce costs. At the same time, their expansion will enable them to use the economies of scale of their centralized buying team to procure large quantities of specific produce categories at cheaper prices. **2)**

**Private Label Product Growth:** SFM is expanding its private label product lines, which are higher margin than its other goods. These accounted for 16% of total revenue in FY 2020 and are projected to generate ~20% of total revenue over the next few years. The diversity of private label products has also been increasing and grew by ~25% from last year's selection. Additionally, an increase in private label products can be attributed to greater customer loyalty as can be seen with Trader Joe's. Greater customer loyalty (where SFM already has a head start with a +65 net promoter score among frequent shoppers compared to an industry average of +51) translates into increased gross margins over time due to customers migrating from produce to higher margin departments and larger basket sizes. TJ has the best in-class private label products, which make up ~80% of the store's total products and drive customer foot traffic. They also contribute to higher margins for TJ by removing slotting, marketing, and middleman fees. SFM recently hired Doug

Rauch, a former TJ executive, to help lead its private label strategy as it aspires to become a “health focused” Trader Joe’s. This is an optimal time for SFM to grow its private label as the pandemic driven recession is leading more people to try it and 80% of shoppers believe that private label is as good or better than national brands. **3) Dedication to Digital Transformation:** Sprouts has been aggressively building its online community and e-commerce capabilities and transitioning to a higher ROI targeted digital ad campaign. Featured on popular health enthusiast vloggers (>1.3 mn subscribers), Sprouts has a growing community of “health enthusiast” and “experience seeker” customers. Vloggers have filmed “Spouts Hauls” with views (289k), compared to Kroger hauls (70k), Publix hauls (74k), and Whole Food Hauls (229k). Furthermore, Sprouts offers recipe blogs online with its ingredients listed with a one-click shopping option, allowing customers to directly add grocery items into their cart. Furthermore, Sprouts transitioned from print ads to weekly digital ads, which reached 49 million more confirmed views on a weekly basis. These more profitable promotions can further accelerate Sprout’s advertising strategy to reach more customers, as its aided awareness still sits at 61% in comparison to 82% for its specialty peers.

**Risks and Catalysts**

Potential risks associated with SFM stock include 1) hindrances to SFM’s expansion strategy in FL due to Publix, who is also taking advantage of Earth Fare and Lucky Market’s bankruptcies, 2) margin compression in 2019 leading to questions about whether SFM will meet management expectations of a 4.8% EBIT margin in 2021 with the imminent threat of a minimum wage hike and the rising commodity costs across the industry (→ SFM is structurally improving margins with more efficient & smaller stores, private label product growth, attribute driven products, shrink improvement, a robust omni channel offering, & smarter promotion & customer targeting to address concerns), and 3) SFM’s push to decrease print marketing and commodity driven promotional events in the face of negative foot traffic and reopening headwinds (→ SFM is shifting to a stronger everyday price position, cutting back on unprofitable promotions, & launching targeted more effective digital campaigns, which all may create traffic headwinds in the ST, but will lead to more profitable customers responding in the LT). Catalysts associated with SFM stock include 1) a growing online health enthusiast community bolstering customer loyalty, 2) the rise of in-store innovation centers and unique eCommerce platform features that specifically cater to profitable target customer demographics, and 3) redesigned small box stores that are projected to increase sales/square ft. (as depicted in consumer surveys) and drive down operating costs.

**Management**

SFM boasts a highly qualified management team consisting of Jack Sinclair (Chief Executive Officer), Scott Neal (Chief Fresh Merchandising Officer), and Gilliam Phipps (Chief Marketing Officer). Jack Sinclair has over 35 years of retail and grocery experience. He was formerly the CEO of 99 Cents Only and the Executive VP of Grocery Division of Walmart. Scott Neal has 25+ years of retail experience and was formerly the senior vice president and general merchandise manager for the fresh food division of Walmart U.S. Sprouts has been shifting to a balance of everyday accessible pricing and fewer ads, a strategy perfected by Walmart where their key management previously held positions. In addition, Gilliam Phipps is a former Kroger private label and branding specialist. His expertise will be invaluable to Sprouts private label expansion strategy. Sprouts executives receive performance- based cash bonuses which incentivizes their commitment to the country’s growth. About 40-50% of their salary bonus is based on reaching Adjusted EBITDA and comparable store sales growth benchmarks, which makes achieving operational efficiency in their best interest. There has also been recent insider purchasing activity.

**Valuation Summary:**

Based on the base case of our valuation summary, we reached a price target of \$34.95. Our revenue build was based on the performance of new and old stores using sales per square foot as a performance indicator for the new smaller box stores and SSS as a driver for older stores. To model SSS and the new store schedule, we backed out historical rates from reported KPIs and used the 2018-2020 store schedules to estimate the proportion of stores opened each quarter. Major assumptions in our cost build included gradually deleveraging COGS a total of 200BPS by 2022 due to DCs, shrink reduction initiatives, and improved produce sourcing.

| Case                              | Base    | Bear    | Bull    |
|-----------------------------------|---------|---------|---------|
| 22-23 Store Count Growth          | 10%     | 7%      | 12%     |
| Comparable Store Sales            | 3%      | 1.50%   | 4%      |
| COGS as a % of Revenue            | 63.6%   | 64.5%   | 63.0%   |
| Implied Price                     | \$34.95 | \$25.22 | \$37.59 |
| Implied Upside                    | 45.3%   | 4.9%    | 56.3%   |
| Probability                       | 70%     | 20%     | 10%     |
| Probability-Weighted Price Target | \$33.27 |         |         |
| Implied Upside                    | 38.3%   |         |         |