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UNDETERRED BY DETERIORATING SAME STORE SALES GROWTH, **SPROUTS' AGGRESSIVE EXPANSION PLANS** HAVE EXTENDED THE COMPANY INTO **TERRITORY OCCUPIED** BY A **POTENTIAL TAKEOVER TARGET**. > *By Gina Acosta and Mike Troy*

An hour before the May grand opening of a new Sprouts store in Tampa, Fla., dozens of shoppers were lined up in 90-degree heat to try their hand at milking a cow. The large black and white cow made for an odd sight, but giving shoppers an up-close-and-personal view into dairy farming is a perfect fit for a retailer with a “healthy living for less” value proposition.

Sprouts' emphasis on all things fresh and customer service was evident on opening day. While moms, dads and kids took turns tugging on teats, free samples of organic chocolate milk were served. As more people arrived at the store carrying reusable shopping bags, they were met by applause and singing from cheerful Sprouts staff. Employees offered samples of organic rotisserie chicken, deli meats and sushi while flat screen TVs played video tutorials on healthful diets. Beautiful fresh displays and organic pineapples priced at \$1 apiece turned heads.

It was the type of reception Sprouts needs given the dynamics of the natural and organic space. The operator of 270 stores is entering new markets and expanding in existing markets where, as Whole Foods Market has learned, there is now abundant competition for shoppers. The Tampa market is dominated by Publix, which operates nearly 800 locations throughout Florida and is regarded for its fresh efforts and Greenwise brand. In the affluent South Tampa Neighborhood where the newest Sprouts is

located, shoppers have their choice of Trader Joe's, Whole Foods and The Fresh Market within a mile. To be sure, Sprouts does have a key point of differentiation related to its approach to produce merchandising, which accounts for about 15 percent of the selling space in a typical 28,000-sq.-ft. store, but generates 24 percent of sales. Whether in Tampa or other markets, the presentation of produce on low fixtures in the center of the store gives Sprouts a farmers market feel. The fresh emphasis extends to the meat department, where

Sprouts employs in-store butchers and promotes an offering that is additive-free and never frozen. The vitamin and body care department features more than 7,500 products made with sustainable and ethically sourced ingredients. Sprouts also drives differentiation with its private brand, which now numbers 2,100 items and accounted for 11 percent of 2016 total sales of \$4 billion.

The newest Tampa location also contained new features that indicate how Sprouts is thinking about future opportunities. For example, an enlarged prepared foods area includes more snacks to go and a new offering of ready-to-heat meals are designed to satisfy all manner of diets, from paleo to low carb to gluten-free. An expanded deli, an initiative that will arrive in 50 stores this year, offers \$3.99 sandwiches made to order, a salad bar, fresh juices, a soup station and freshly prepared proteins and side items. A new “Fresh Finds” cooler features an array of supplements to support gastrointestinal health. An enlarged refrigerated bread case offers preservative-free products.

“The Sprouts model of fresh, natural and organic products at prices the everyday shopper can afford continues to resonate with our customers,” Sprouts CEO Amin Maredia said during the company's first quarter earnings call. “We remain focused on delivering innovative products and connecting with our customers both in and out of the store. This focus continues to produce exceptional customer engagement and service scores, strong operations and solid financial results.”

Sprouts, along with many other retailers, is riding a wave of growth fueled by healthy eating aspirations and a well-established organic movement that has become mainstream. Organic food sales increased 8.4 percent in 2016 to around \$47 billion, representing 5.3 percent of total U.S. food sales, according to the Organic Trade Association's industry survey released in May. That type of growth rate would attract a crowd in any retail sector, but especially in the food channel where operators have grown accustomed to growth rates in the single digits and persistent deflation.

Deflation has been a headwind for Sprouts too, receiving most of the blame for a 1.1 percent same store sales increase during the first quarter and muted expectations for full year growth in the range of 0.5 percent to 1.5 percent. The first quarter comp increase was noteworthy in that it was the 40th consecutive quarter of growth. However, warnings signs have begun to emerge as the key indicator of performance has deteriorated every year since peak-



▲ Sprouts CEO Amin Maredia



The 270th Sprouts Farmers Market opened in May in South Tampa, Fla. The store will compete with Publix, Trader Joe's and The Fresh Market all located nearby.



ing at 10.7 percent in 2013. That was the year Sprouts private equity owners, the Apollo Management Group, took the company public. Comps remained strong at 9.9 percent the following year and by March 2015, Apollo had exited its position in Sprouts.

That same year, Sprouts experienced a senior leadership transition that year that saw Maredia become CEO in August 2015 after serving the prior four years as CFO. His CFO position was filled in March 2016 by Brad Lukow, a former 99 Cents Only and Shoppers Drug Mart CFO Brad Lukow. During Maredia's first year as CEO, same store sales continued to grow but advanced at a lesser rate of 5.8 percent, followed by a 2.7 percent increase in 2016. If 2017 comps materialize as expected it will be Sprouts slowest rate of growth since 2013, despite the addition of more than 100 new locations since going public, including a record 36 new stores last year.

Sprouts is committed to opening more stores, especially in the Southeast, but the prospect of an acquisition also seems possible if Sprouts' history and the track record of the company's former private equity owner are any indication. Roughly one year after exiting Sprouts, Apollo re-entered the natural and organic space with its April 2016 acquisition of The Fresh Market, a company in the path of Sprouts' eastward expansion.

Sprouts opened a fresh distribution center in Atlanta last December to serve stores in the Southeast, including a concentration of 16 stores in Atlanta. Beyond that, the company has relatively few stores in the region with six stores spread between Memphis and Nashville, one location in North Carolina and the initial locations in Florida.

Meanwhile, The Fresh Market's highest concentration of stores is in Florida, where it operates 45 stores, followed by North Carolina with 22 stores, Virginia and Georgia with 15 each and a lesser number in adjacent states serviceable from a distribution center in Atlanta.

The Fresh Market is already in many of the places where Sprouts would like to be, but that doesn't mean

a deal will get done. Fresh Market stores tend to be smaller, about 21,000-sq.-ft., compared to the typical 28,000-sq.-ft. Sprouts stores, so there would be operational considerations in play. For example, delivering a Sprouts experience with a strong and theatrical fresh presentation in a smaller footprint Fresh Market store would create challenges.

Even so, Apollo has a history of serving as a consolidator in the natural and organic space. The firm was the force behind the 2011 combination of Sprouts and Henry's Holdings, operator of 35 Henry's Farmers Market stores and eight Sun Harvest Market stores. The following year, the company controlled by Apollo acquired 37 Sunflower Farmers Market stores, which resulted in the Sprouts chain that investors bought into with the 2013 IPO. Even without an acquisition, Sprouts has a strong organic pipeline in place with 63 approved sites and 43 signed leases, according to Maredia, who noted the company is also making investments.

"We are investing in infrastructure to support our store growth and drive productivity improvements. Our technology projects are progressing as planned, focused on driving efficiencies both at the store level and the support office. All of this is key for scale and will enhance the experience of our team members and customers alike, driving retention and improving service in the store," Maredia said. The company is also focused on the digital future. Sprouts says it plans to expand a 10-store test of providing home delivery through Amazon's Prime Now one-hour delivery service with a goal of 20 stores this year. "We're now exiting the pilot phase and we are ready to ramp and to accelerate into more of our markets by year-end," Maredia said. "We would expect to have at least a couple of stores in most of our major markets as well as build out a more robust plan for 2018." **RL**