

## Section 1: 10-Q (FORM 10-Q)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549  
**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 28, 2014

Commission File Number: 001-36029



## Sprouts Farmers Market, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**32-0331600**  
(I.R.S. Employer  
Identification No.)

**11811 N. Tatum Boulevard, Suite 2400**  
**Phoenix, Arizona 85028**  
(Address of principal executive offices and zip code)

**(480) 814-8016**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 4, 2014, there were outstanding 150,951,436 shares of the registrant's common stock, \$0.001 par value per share.

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 28, 2014

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### Explanatory Note

On July 29, 2013, Sprouts Farmers Markets, LLC, a Delaware limited liability company, converted into Sprouts Farmers Market, Inc., a Delaware corporation, as described under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Factors Affecting Comparability of Results of Operations—Corporate Conversion.” As used in this Quarterly Report on Form 10-Q, unless the context otherwise requires, references to the “Company,” “Sprouts,” “we,” “us” and “our” refer to Sprouts Farmers Markets, LLC and, after the corporate conversion, to Sprouts Farmers Market, Inc. and, where appropriate, its subsidiaries. In the corporate conversion, each unit of Sprouts Farmers Markets, LLC was converted into 11 shares of common stock of Sprouts Farmers Market, Inc., and each option to purchase units of Sprouts Farmers Markets, LLC was converted into an option to purchase 11 shares of common stock of Sprouts Farmers Market, Inc. For the convenience of the reader, except as the context otherwise requires, all information included in this Quarterly Report on Form 10-Q is presented giving effect to the corporate conversion.

On July 31, 2013, the Company’s Registration Statement on Form S-1 (Reg. No. 333-188493) and the Company’s Registration Statement on Form 8-A became effective, and the Company became subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (referred to as the “Exchange Act”).

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” that involve substantial risks and uncertainties. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the “Securities Act”), and Section 21E of the Exchange Act, including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses, and plans and objectives of management. In some cases, you can identify forward-looking statements by terms such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “project,” “will,” “would,” “should,” “could,” “can,” “predict,” “potential,” “continue,” “objective,” or the negative of these terms, and similar expressions intended to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and involve known risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievement to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled “Risk Factors” included in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K for the fiscal year ended December 29, 2013, and our other filings with the Securities and Exchange Commission. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

## PART I—FINANCIAL INFORMATION

## Item 1. Financial Statements

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	September 28, 2014	December 29, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 118,447	\$ 77,652
Accounts receivable, net	14,077	9,524
Inventories	140,104	118,256
Prepaid expenses and other current assets	6,406	8,049
Deferred income tax asset	8,775	18,146
Total current assets	287,809	231,627
Property and equipment, net of accumulated depreciation	416,916	348,830
Intangible assets, net of accumulated amortization	194,499	195,467
Goodwill	368,078	368,078
Other assets	18,210	13,135
Deferred income tax asset	11,571	15,267
Total assets	<u>\$ 1,297,083</u>	<u>\$ 1,172,404</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 122,752	\$ 111,159
Accrued salaries and benefits	25,661	22,287
Income taxes payable	4,133	—
Other accrued liabilities	34,640	32,958
Current portion of capital and financing lease obligations	3,995	3,395
Current portion of long-term debt	6,008	5,822
Total current liabilities	197,189	175,621
Long-term capital and financing lease obligations	122,654	116,177
Long-term debt	251,848	305,418
Other long-term liabilities	74,832	61,417
Total liabilities	646,523	658,633
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Undesignated preferred stock; \$0.001 par value; 10,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 200,000,000 shares authorized, 150,643,564 and 147,616,560 shares issued and outstanding, September 28, 2014 and December 29, 2013, respectively	150	147
Additional paid-in capital	525,964	479,127
Retained earnings	124,446	34,497
Total stockholders' equity	650,560	513,771
Total liabilities and stockholders' equity	<u>\$ 1,297,083</u>	<u>\$ 1,172,404</u>

The accompanying notes are an integral part of these consolidated financial statements.

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**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**  
**(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Net sales	\$ 766,415	\$ 633,614	\$ 2,232,831	\$ 1,829,675
Cost of sales, buying and occupancy	540,367	443,509	1,558,876	1,278,623
Gross profit	226,048	190,105	673,955	551,052
Direct store expenses	148,633	129,418	430,019	367,064
Selling, general and administrative expenses	24,015	22,807	69,594	60,259
Store pre-opening costs	3,684	1,237	7,051	5,254
Store closure and exit costs	60	(38)	393	1,670
Income from operations	49,656	36,681	166,898	116,805
Interest expense	(6,157)	(8,790)	(19,144)	(30,346)
Other income	281	203	477	447
Loss on extinguishment of debt	(1,138)	(9,507)	(1,138)	(17,682)
Income before income taxes	42,642	18,587	147,093	69,224
Income tax provision	(16,577)	(7,126)	(57,144)	(27,178)
Net income	<u>\$ 26,065</u>	<u>\$ 11,461</u>	<u>\$ 89,949</u>	<u>\$ 42,046</u>
Net income per share:				
Basic	\$ 0.17	\$ 0.08	\$ 0.60	\$ 0.32
Diluted	\$ 0.17	\$ 0.08	\$ 0.58	\$ 0.31
Weighted average shares outstanding:				
Basic	<u>150,241</u>	<u>139,687</u>	<u>149,227</u>	<u>130,538</u>
Diluted	<u>154,306</u>	<u>144,710</u>	<u>153,879</u>	<u>134,529</u>

The accompanying notes are an integral part of these consolidated financial statements.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**(UNAUDITED)**  
**(IN THOUSANDS, EXCEPT SHARE AMOUNTS)**

	Shares	Common Stock	Additional Paid In Capital	(Accumulated Deficit) / Retained Earnings	Total Stockholders' Equity
<b>Balances at December 30, 2012</b>	125,956,721	\$ 126	\$ 395,480	\$ (8,851)	\$ 386,755
Net income	—	—	—	51,326	51,326
Issuance of shares under option plans	1,194,999	1	3,820	—	3,821
Issuance of shares in IPO, net of issuance costs	20,477,215	20	344,304	—	344,324
Repurchase of shares	(12,375)	—	(113)	—	(113)
Dividend paid to stockholders	—	—	(274,051)	(7,978)	(282,029)
Antidilution payments made to optionholders	—	—	(13,892)	—	(13,892)
Excess income tax benefit for exercise of options	—	—	13,424	—	13,424
Tax benefit of antidilution payments made to optionholders	—	—	4,402	—	4,402
Tax effect of forfeiture of vested options in equity	—	—	(27)	—	(27)
Equity-based compensation	—	—	5,780	—	5,780
<b>Balances at December 29, 2013</b>	147,616,560	\$ 147	\$ 479,127	\$ 34,497	\$ 513,771
Net income	—	—	—	89,949	89,949
Issuance of shares under option plans	3,027,004	3	7,602	—	7,605
Excess income tax benefit for exercise of options	—	—	35,041	—	35,041
Equity-based compensation	—	—	4,194	—	4,194
<b>Balances at September 28, 2014</b>	150,643,564	\$ 150	\$ 525,964	\$ 124,446	\$ 650,560

The accompanying notes are an integral part of these consolidated financial statements.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
**(IN THOUSANDS)**

	Thirty-Nine Weeks Ended	
	September 28, 2014	September 29, 2013
<b>Cash flows from operating activities</b>		
Net income	\$ 89,949	\$ 42,046
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	40,586	34,860
Accretion of asset retirement obligation and closed store reserve	755	84
Amortization of financing fees and debt issuance costs	1,152	2,041
Loss on disposal of property and equipment	1,038	437
Gain on sale of intangible assets	—	(19)
Equity-based compensation	4,194	4,285
Non-cash loss on extinguishment of debt	1,138	17,474
Deferred income taxes	13,067	20,070
Changes in operating assets and liabilities:		
Accounts receivable	(4,654)	(721)
Inventories	(21,848)	(16,383)
Prepaid expenses and other current assets	1,617	(9,752)
Other assets	(5,474)	(3,875)
Accounts payable	7,094	39,808
Accrued salaries and benefits	3,374	(469)
Other accrued liabilities and income taxes payable	5,814	(1,359)
Other long-term liabilities	13,499	9,777
Net cash provided by operating activities	<u>151,301</u>	<u>138,304</u>
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(96,099)	(74,777)
Proceeds from sale of intangible assets	—	172
Proceeds from sale of property and equipment	232	2
Net cash used in investing activities	<u>(95,867)</u>	<u>(74,603)</u>
<b>Cash flows from financing activities</b>		
Borrowing on term loan, net of financing costs	—	688,127
Payments on term loan	(55,250)	(745,100)
Payments on senior subordinated notes	—	(35,000)
Payments on capital lease obligations	(426)	(335)
Payments on financing lease obligations	(2,186)	(2,104)
Payments of deferred financing costs	—	(1,370)
Payments of IPO costs	—	(4,212)
Cash from landlord related to financing lease obligations	577	4,057
Payments to stockholders and option holders	—	(295,921)
Repurchase of shares	—	(113)
Excess tax benefit for exercise of stock options and antidilution payment to optionholders	35,041	4,402
Proceeds from the exercise of stock options	7,605	75
Proceeds from the issuance of shares	—	348,317
Net cash used in financing activities	<u>(14,639)</u>	<u>(39,177)</u>
Net increase in cash and cash equivalents	40,795	24,524
Cash and cash equivalents at beginning of the period	77,652	67,211
Cash and cash equivalents at the end of the period	<u>\$ 118,447</u>	<u>\$ 91,735</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 18,164	\$ 31,529
Cash paid for income taxes	3,982	1,276
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Property and equipment in accounts payable	\$ 12,156	\$ 6,332
Property acquired through capital and financing lease obligations	9,113	10,986

The accompanying notes are an integral part of these consolidated financial statements.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. Basis of Presentation**

Sprouts Farmers Market, Inc., a Delaware corporation, through its subsidiaries, operates as a healthy grocery store that offers fresh, natural and organic food that includes fresh produce, bulk foods, vitamins and supplements, grocery, meat and seafood, bakery, dairy, frozen foods, body care and natural household items catering to consumers' growing interest in eating and living healthier. The "Company" is used to refer collectively to Sprouts Farmers Market, Inc. and its subsidiaries.

The accompanying unaudited consolidated financial statements include the accounts of the Company in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial statements and are in the form prescribed by the Securities and Exchange Commission in instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial position, results of operations and cash flows for the periods indicated. All material intercompany accounts and transactions have been eliminated in consolidation. Interim results are not necessarily indicative of results for any other interim period or for a full fiscal year. The information included in these consolidated financial statements and notes thereto should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included herein and Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto for the fiscal year ended December 29, 2013 included in the Company's Annual Report on Form 10-K, filed on February 27, 2014.

The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

The Company reports its results of operations on a 52- or 53-week fiscal calendar ending on the Sunday closest to December 31. Fiscal years 2014 and 2013 are 52-week years. The Company reports its results of operations on a 13-week quarter, except for 53-week fiscal years.

The Company has revised its Statement of Cash Flows for the thirty-nine weeks ended September 29, 2013, to present cash inflows related to excess tax benefits from antidilution payments made to optionholders as cash flows from financing activities. This revision did not have a material impact on previously reported consolidated cash flows. Additionally, for the thirty-nine weeks ended September 28, 2014, and for the comparative period, the Company has offset the changes in balance sheet line items related to excess tax benefit with the excess tax benefit.

On August 6, 2013, the Company completed its initial public offering ("IPO") of 21,275,000 shares of common stock at a price of \$18.00 per share. The Company sold 20,477,215 shares of common stock, and certain stockholders sold the remaining 797,785 shares. The Company received net proceeds from the IPO of \$344.1 million, after deducting underwriting discounts and offering expenses. See Note 11, "Stockholders' Equity" for more information.

The Company has one reportable and one operating segment.

The Company's business is subject to modest seasonality. Average weekly sales fluctuate throughout the year and are typically highest in the first half of the fiscal year. Produce, which contributed 26% of the Company's net sales for the thirty-nine weeks ended September 28, 2014, is generally more available in the first six months of the fiscal year due to the timing of peak growing seasons.

All dollar amounts are in thousands, unless otherwise noted.



**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED) — continued**

**2. Recently Issued Accounting Pronouncements**

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-04, “Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force),” which amends Accounting Standards Codification (“ASC”) 405, “Liabilities.” The amendments provide guidance on the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements, including debt arrangements, other contractual obligations, and settled litigation and judicial rulings, for which the total amount of the obligation is fixed at the reporting date. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied retrospectively. The provisions were effective from the Company’s first quarter of 2014. The adoption of this guidance did not have a material effect on the Company’s consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,” which amends ASC 740, “Income Taxes.” ASU No. 2013-11 requires that unrecognized tax benefits be classified as an offset to deferred tax assets to the extent of any net operating loss carryforwards, similar tax loss carryforwards, or tax credit carryforwards are available at the reporting date in the applicable tax jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position. An exception would apply if the tax law of the tax jurisdiction does not require the Company to use, and it does not intend to use, the deferred tax asset for such purpose. This guidance is effective for reporting periods beginning after December 15, 2013. The provisions were effective from the Company’s first quarter of 2014. The adoption of this guidance did not have a material effect on the Company’s consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” ASU No. 2014-08 amends previous guidance related to the criteria for reporting a disposal as a discontinued operation by elevating the threshold for qualification for discontinued operations treatment to a disposal that represents a strategic shift that has a major effect on an organization’s operations or financials results. This guidance also requires expanded disclosures for transactions that qualify as a discontinued operation and requires disclosure of individually significant components that are disposed of or held for sale but do not qualify for discontinued operations reporting. This guidance is effective prospectively for all disposals or components initially classified as held for sale in periods beginning on or after December 15, 2014, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material effect on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers.” ASU No. 2014-09 provides guidance for revenue recognition. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, and estimating the amount of variable consideration to include in the transaction price attributable to each separate performance obligation. This guidance will be effective for the Company for its fiscal year 2017. The Company is currently evaluating the potential impact of this guidance.

In August 2014, the FASB issued ASU No. 2014-15, “Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern.” ASU No. 2014-15 requires management to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. This guidance will be effective for the Company for its fiscal year 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material effect on its consolidated financial statements.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED) — continued**

**3. Fair Value Measurements**

The Company records its financial assets and liabilities in accordance with the framework for measuring fair value in accordance with GAAP. This framework establishes a fair value hierarchy that prioritizes the inputs used to measure fair value:

Level 1: Quoted prices for identical instruments in active markets.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in the impairment analysis of goodwill, indefinite-lived intangible assets, long-lived assets and in the valuation of store closure and exit costs.

The determination of fair values of certain tangible and intangible assets for purposes of the Company's goodwill impairment evaluation as described above was based upon a step zero assessment. Closed store reserves are recorded at net present value to approximate fair value which is classified as Level 3 in the hierarchy. The estimated fair value of the closed store reserve is calculated based on the present value of the remaining lease payments and other charges using a weighted average cost of capital, reduced by estimated sublease rentals. The weighted average cost of capital was estimated using information from comparable companies and management's judgment related to the risk associated with the operations of the stores.

Cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued salaries and benefits and other accrued liabilities approximate fair value because of the short maturity of those instruments. Based on open market transactions comparable to the Term Loan (as defined in Note 6, "Long-Term Debt"), the fair value of the long-term debt, including current maturities, approximates carrying value as of September 28, 2014 and December 29, 2013. The Company's estimates of the fair value of long-term debt (including current maturities) were classified as Level 2 in the fair value hierarchy.

**4. Accounts Receivable**

A summary of accounts receivable is as follows:

	As Of	
	September 28, 2014	December 29, 2013
Vendor	\$ 8,731	\$ 5,183
Receivables from landlords	3,094	1,034
Medical insurance receivables	37	1,089
Other	2,215	2,218
<b>Total</b>	<b>\$ 14,077</b>	<b>\$ 9,524</b>

Medical insurance receivables relate to amounts receivable from the Company's health insurance carrier for claims in excess of stop-loss limits.

The Company had recorded allowances for certain vendor receivables of \$0.1 million and \$0.3 million at September 28, 2014 and December 29, 2013, respectively.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED) — continued**

**5. Accrued Salaries and Benefits**

A summary of accrued salaries and benefits is as follows:

	As Of	
	September 28, 2014	December 29, 2013
Bonuses	\$ 10,074	\$ 8,393
Accrued payroll	7,718	6,904
Vacation	7,363	6,634
Other	506	356
<b>Total</b>	<b>\$ 25,661</b>	<b>\$ 22,287</b>

**6. Long-Term Debt**

A summary of long-term debt is as follows:

Facility	Maturity	Interest Rate	As Of	
			September 28, 2014	December 29, 2013
<b>Senior Secured</b>				
Term Loan, net of original issue discount	April 2020	Variable	\$ 257,856	\$ 311,240
\$60.0 million Revolving Credit Facility	April 2018	Variable	—	—
<b>Total debt</b>			257,856	311,240
Less current portion			(6,008)	(5,822)
<b>Long-term debt, net of current portion</b>			<b>\$ 251,848</b>	<b>\$ 305,418</b>

Current portion of long-term debt is presented net of issue discount of \$1.0 million and \$1.2 million as of September 28, 2014 and December 29, 2013, respectively. The non-current portion of long-term debt is presented net of issue discount of \$4.2 million and \$5.8 million as of September 28, 2014 and December 29, 2013, respectively.

**Senior Secured Credit Facilities**

*April 2013 Refinancing*

On April 23, 2013, the Company's subsidiary, Sprouts Farmers Markets Holdings, LLC ("Intermediate Holdings"), as borrower, refinanced (the "April 2013 Refinancing") its former revolving credit facility and former term loan, by entering into a new credit facility (the "Credit Facility"). The Credit Facility provides for a \$700.0 million term loan (the "Term Loan") and a \$60.0 million senior secured revolving credit facility (the "Revolving Credit Facility").

The terms of the Credit Facility allow the Company, subject to certain conditions, to increase the amount of the term loans and revolving commitments thereunder by an aggregate incremental amount of up to \$160.0 million, plus an additional amount, so long as after giving effect to such increase, (i) in the case of incremental loans that rank pari passu with the initial term loans, the net first lien leverage ratio does not exceed 4.00 to 1.00, and (ii) in the case of incremental loans that rank junior to the initial Term Loan, the total leverage ratio does not exceed 5.25 to 1.00.

*Guarantees*

Obligations under the Credit Facility are guaranteed by the Company and all of its current and future wholly owned material domestic subsidiaries. Borrowings under the Credit Facility are secured by (i) a pledge by Sprouts of its equity interests in Intermediate Holdings and (ii) first-priority liens on substantially all assets of Intermediate Holdings and the subsidiary guarantors, in each case, subject to permitted liens and certain exceptions.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED) — continued**

*Interest and Applicable Margin*

All amounts outstanding under the Credit Facility will bear interest, at the Company's option, at a rate per annum equal to LIBOR (with a 1.00% floor with respect to Eurodollar borrowings under the Term Loan), adjusted for statutory reserves, plus a margin equal to 3.00%, or an alternate base rate, plus a margin equal to 2.00%, as set forth in the Credit Facility. These interest margins were reduced to their current levels (from 3.50% and 2.50%, respectively) effective August 2, 2013, as a result of (i) the consummation of the Company's IPO, and (ii) the Company achieving a reduction in the net first lien leverage ratio to less than or equal to 2.75 to 1.00.

*Payments and Prepayments*

On August 14, 2014 the Company made a \$50.0 million voluntary principal payment on the Term Loan. Such payment resulted in a \$1.1 million loss on extinguishment of debt due to the write-off of deferred financing costs and original issue discount for the portion of the debt repaid. This loss on extinguishment of debt is reflected in the Company's statements of operations for the thirteen and thirty-nine weeks ended September 28, 2014.

The Term Loan will mature in April 2020 and will amortize at a rate per annum, in four equal quarterly installments, in an aggregate amount equal to 1.00% of the original principal balance, with the balance due on the maturity date.

Subject to exceptions set forth therein, the Credit Facility requires mandatory prepayments in amounts equal to (i) 50% (reduced to 25% if net first lien leverage is less than 3.00 to 1.00 but greater than 2.50 to 1.00 and 0% if net first lien leverage is less than 2.50 to 1.00) of excess cash flow (as defined in the Credit Facility) at the end of each fiscal year, (ii) 100% of the net cash proceeds from certain non-ordinary course asset sales by the Company or any subsidiary guarantor (subject to certain exceptions and reinvestment provisions) and (iii) 100% of the net cash proceeds from the issuance or incurrence of debt by the Company or any of its subsidiaries not permitted under the Credit Facility.

Voluntary prepayments of borrowings under the Credit Facility are permitted at any time, in agreed-upon minimum principal amounts. Prepayments will not be subject to premium or penalty (except LIBOR breakage costs, if applicable).

*Revolving Credit Facility*

The Credit Facility includes a \$60.0 million Revolving Credit Facility which matures in April 2018. The Revolving Credit Facility includes letter of credit and \$5.0 million swingline loan subfacilities. Letters of credit issued under the facility reduce the borrowing capacity on the total facility. There are no amounts outstanding on the Revolving Credit Facility at September 28, 2014. Letters of credit totaling \$7.4 million have been issued as of September 28, 2014 primarily to support the Company's insurance programs. Amounts available under the Revolving Credit Facility at September 28, 2014 totaled \$52.6 million.

Interest terms on the Revolving Credit Facility are the same as the Term Loan.

The Company capitalized debt issuance costs of \$1.1 million related to the Revolving Credit Facility, which are being amortized to interest expense over the term of the Revolving Credit Facility.

Under the terms of the Credit Facility, the Company is obligated to pay a commitment fee on the available unused amount of the Revolving Credit Facility commitments equal to 0.50% per annum.

*Covenants*

The Credit Facility contains financial, affirmative and negative covenants. The negative covenants include, among other things, limitations on the Company's ability to:

- incur additional indebtedness;
- grant additional liens;
- enter into sale-leaseback transactions;

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- make loans or investments;
- merge, consolidate or enter into acquisitions;
- pay dividends or distributions;
- enter into transactions with affiliates;
- enter into new lines of business;
- modify the terms of subordinated debt or other material agreements; and
- change its fiscal year

Each of these covenants is subject to customary or agreed-upon exceptions, baskets and thresholds.

In addition, if the Company has any amounts outstanding under the Revolving Credit Facility as of the last day of any fiscal quarter, the Revolving Credit Facility requires the borrower to maintain a ratio of Revolving Facility Credit exposure to consolidated trailing 12-month EBITDA (as defined in the Credit Facility) of no more than 0.75 to 1.00 as of the end of each such fiscal quarter.

The Company was in compliance with all applicable covenants under the Credit Facility as of September 28, 2014.

**7. Closed Store Reserves**

The following is a summary of closed store reserve activity during the thirty-nine weeks ended September 28, 2014 and fiscal year ended December 29, 2013:

	<u>September 28,</u> <u>2014</u>	<u>December 29,</u> <u>2013</u>
Beginning balance	\$ 4,713	\$ 5,243
Additions	688	363
Usage	(1,407)	(1,728)
Adjustments	(586)	835
Ending balance	<u>\$ 3,408</u>	<u>\$ 4,713</u>

Additions made during 2014 relate to the closure and relocation of one store and to the closure and relocation of the Texas warehouse, and usage during 2014 relates to lease payments made during the period for closed stores. Adjustments made during 2014 include a \$0.4 million favorable reserve adjustment due to a sublease for the Sunflower administrative office and a \$1.2 million favorable reserve adjustment for one store due to settlement with the landlord recorded during the thirteen weeks ended September 28, 2014. Also during the thirteen weeks ended September 28, 2014, the Company determined that it should have been recording accretion expense for store closure reserves and liability for certain occupancy costs. The Company made a correcting entry of \$0.9 million to adjust the liability for closed stores to include such accretion and liability for certain occupancy costs for prior periods. The effect of this error on the Company's financial statements was not material to any period. Activity during 2013 includes charges related to the closure of a former Sunflower warehouse, lease payments made during the period for closed stores and adjustments to sublease estimates for stores and facilities already closed.

**8. Income Taxes**

The Company's effective tax rate for the thirteen weeks ended September 28, 2014 and September 29, 2013 was 38.9% and 38.3%, respectively. The primary reasons for the increase in the effective tax rate were the result of a reduction in the net deferred tax asset because of a decrease in the statutory state income tax rate and a reduction in the deferred tax asset for income tax credits partially offset by provision to tax return adjustments for the 2013 income tax return. The impacts of the items noted above were recorded in the quarter.

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The Company's effective tax rate for the thirty-nine weeks ended September 28, 2014 and September 29, 2013 was 38.9% and 39.3%, respectively. The decrease in the effective tax rate was the result of an increase in the enhanced charitable food contribution.

In September 2013, the Internal Revenue Service issued final regulations related to tangible property, which govern when a taxpayer must capitalize or deduct expenses for acquiring, maintaining, repairing and replacing tangible property. The regulations are effective for tax years beginning January 1, 2014, however early adoption is permitted. The Company has analyzed the impacts of the tangible property regulations, and has determined it is in compliance with the regulations. The adoption of the regulations has not had a material effect on the Company's consolidated financial statements.

Excess tax benefits associated with stock option exercises are credited to stockholders' equity. The Company uses the tax law ordering approach of intraperiod allocation to allocate the benefit of windfall tax benefits based on provisions in the tax law that identify the sequence in which those amounts are utilized for tax purposes. The income tax benefits resulting from stock awards that were credited to stockholders' equity were \$35.0 million for the thirty-nine weeks ended September 28, 2014, which included \$1.5 million of income tax benefits related to stock award activity in 2013. The income tax benefits resulting from antidilution payments that were credited to stockholders' equity were \$4.4 million for the thirty-nine weeks ended September 29, 2013. The excess tax benefits are not credited to stockholders' equity until the deduction reduces income taxes payable.

**9. Related-Party Transactions**

Two stockholders, including a member of the Company's board of directors, are investors in a company that is a supplier of coffee to the Company. During the thirteen weeks ended September 28, 2014 and September 29, 2013, purchases from this company were \$2.0 million and \$1.7 million, respectively. During the thirty-nine weeks ended September 28, 2014 and September 29, 2013, purchases from this company were \$5.8 million and \$5.6 million, respectively. At both September 28, 2014 and September 29, 2013, the Company had recorded accounts payable due to this vendor of \$0.6 million.

The Company was party to a services agreement (the "Services Agreement") with an outsourced service provider who is a stockholder of the Company, to perform certain of the Company's bookkeeping services including general ledger maintenance, accounts payable processing and cash management. The Services Agreement provides for successive one-year terms unless either party provides six months' termination notice. During the thirteen weeks ended September 28, 2014 and September 29, 2013, fees and other expenses paid to the service provider under the terms of the Services Agreement were \$0.1 million and \$0.6 million, respectively. During the thirty-nine weeks ended September 28, 2014 and September 29, 2013, fees and other expenses paid to the service provider under the terms of the Services Agreement were \$1.0 million and \$1.8 million, respectively. The Services Agreement expired in accordance with its terms on September 1, 2014.

**10. Commitments and Contingencies**

The Company is exposed to claims and litigation matters arising in the ordinary course of business and uses various methods to resolve these matters that are believed to best serve the interests of the Company's stakeholders. The Company's primary contingencies are associated with self-insurance obligations. Self-insurance liabilities require significant judgment and actual claim settlements and associated expenses may differ from the Company's current provisions for loss.

**11. Stockholders' Equity**

***Secondary Offerings***

On April 2, 2014, certain of the Company's stockholders completed a secondary public offering of 17,250,000 shares of common stock, which included 1.6 million options exercised and sold by certain of the Company's option holders (the "April Secondary Offering"). On August 18, 2014, certain of the Company's stockholders completed a secondary public offering of 17,158,191 shares of common stock,

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which included 0.7 million options exercised and sold by certain of the Company's option holders (the "August Secondary Offering"). See Note 13, "Equity-Based Compensation" for more details on the option exercises in the April Secondary Offering and the August Secondary Offering. The Company did not sell any shares in either the April Secondary Offering or the August Secondary Offering.

**Initial Public Offering**

On August 6, 2013, the Company completed its IPO of 21,275,000 shares of common stock at a price of \$18.00 per share. The Company sold 20,477,215 shares of common stock, and certain stockholders sold the remaining 797,785 shares. The Company received gross proceeds from the IPO of approximately \$368.6 million, or \$344.1 million after deducting underwriting discounts and offering expenses of \$24.5 million. The Company did not receive any proceeds from the sale of shares by the selling stockholders. On August 6, 2013, the Company used \$340.0 million of the net proceeds from its IPO to make a partial repayment of the Term Loan.

**Distribution to Stockholders**

On April 24, 2013, the Company paid a total distribution of \$282.0 million to stockholders. Additionally, pursuant to the anti-dilution provisions of the 2011 Option Plan (as defined in Note 13 "Equity-Based Compensation" below), the Company paid \$13.9 million to certain vested option holders and reduced the exercise price of unvested and certain vested options.

The payment was made first from retained earnings to date as of the payment date, and payment in excess of retained earnings was made from additional paid-in capital.

**12. Net Income Per Share**

The computation of net income per share is based on the number of weighted average shares outstanding during the period. The computation of diluted net income per share includes the dilutive effect of share equivalents consisting of incremental shares deemed outstanding from the assumed exercise of options and assumed vesting of restricted stock units ("RSUs").

A reconciliation of the numerators and denominators of the basic and diluted net income per share calculations is as follows (in thousands, except per share amounts):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
<b>Basic net income per share:</b>				
Net income	\$ 26,065	\$ 11,461	\$ 89,949	\$ 42,046
Weighted average shares outstanding	150,241	139,687	149,227	130,538
Basic net income per share	<u>\$ 0.17</u>	<u>\$ 0.08</u>	<u>\$ 0.60</u>	<u>\$ 0.32</u>
<b>Diluted net income per share:</b>				
Net income	\$ 26,065	\$ 11,461	\$ 89,949	\$ 42,046
Weighted average shares outstanding	150,241	139,687	149,227	130,538
Dilutive effect of equity-based awards:				
Assumed exercise of options to purchase shares	4,065	5,023	4,652	3,991
Weighted average shares and equivalent shares outstanding	154,306	144,710	153,879	134,529
Diluted net income per share	<u>\$ 0.17</u>	<u>\$ 0.08</u>	<u>\$ 0.58</u>	<u>\$ 0.31</u>

For the thirteen weeks ended September 28, 2014 the computation of diluted net income per share does not include 1.0 million options as those options would have been antidilutive or were unvested performance-based options. For the thirteen weeks ended September 29, 2013, the computation of diluted net income per share does not include 2.6 million options, as those options would have been antidilutive or were unvested performance-based options.

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For the thirty-nine weeks ended September 28, 2014 the computation of diluted net income per share does not include 1.0 million options as those options would have been antidilutive or were unvested performance-based options. For the thirty-nine weeks ended September 29, 2013, the computation of diluted net income per share does not include 4.5 million options, as those options would have been antidilutive or were unvested performance-based options.

**13. Equity-Based Compensation**

***2013 Incentive Plan***

The Company's board of directors adopted, and its equity holders approved, the Sprouts Farmers Market, Inc. 2013 Incentive Plan (the "2013 Incentive Plan"). The 2013 Incentive Plan became effective July 31, 2013 in connection with the Company's IPO and replaced the Sprouts Farmers Markets, LLC Option Plan (the "2011 Option Plan") (except with respect to outstanding options to acquire shares under the 2011 Option Plan). The 2013 Incentive Plan and 2011 Option Plan are collectively referred to as the "Option Plans". The 2013 Incentive Plan serves as the umbrella plan for the Company's stock-based and cash-based incentive compensation programs for its directors, officers and other team members.

Under the 2013 Incentive Plan, effective July 31, 2013 upon the pricing of the Company's IPO, the Company granted officers and team members options to purchase 396,000 shares of common stock at an exercise price of \$18.00 per share, with grant date fair values of \$4.65 to \$5.92. The Company also granted to independent directors options to purchase 11,112 shares of common stock at an exercise price of \$18.00 per share, with grant date fair values of \$4.65.

On March 4, 2014, under the 2013 Incentive Plan, the Company granted to certain officers and team members time-based options to purchase an aggregate of 320,041 shares of common stock at an exercise price of \$39.01 per share, with a grant date fair value of \$10.66 per share. The Company also granted an aggregate of 108,980 RSUs with a grant date fair value of \$39.01.

On May 19, 2014, under the 2013 Incentive Plan, the Company granted to a team member and to independent members of the Company's board of directors time-based options to purchase an aggregate of 37,047 shares of common stock at an exercise price of \$28.50 per share, with a grant date fair value of \$8.07. The Company also granted to this team member 2,174 RSUs with a grant date fair value of \$28.50 per share.

The aggregate number of shares of common stock that may be issued to team members and directors under the 2013 Incentive Plan may not exceed 10,089,072. Shares subject to awards granted under the 2013 Incentive Plan which are subsequently forfeited, expire unexercised or are otherwise not issued will not be treated as having been issued for purposes of the share limitation.

***2011 Option Plan***

In May 2011, the Company adopted the 2011 Option Plan to provide team members or directors of the Company with options to acquire shares of the Company. The Company had authorized 12,100,000 shares for issuance under the 2011 Option Plan. Options may no longer be issued under the 2011 Option Plan.

During the thirty-nine weeks ended September 29, 2013, the Company awarded 209,000 options to employees under the 2011 Option Plan at exercise prices of \$9.15 and grant date fair values of \$2.33 to \$3.10.



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**Options**

The Company uses the Black-Scholes option pricing model to estimate the fair value of options at grant date. Options vest in accordance with the terms set forth in the grant letter and vary depending on if they are time-based or performance-based.

Time-based options generally vest ratably over a period of 12 quarters (three years) and performance-based options vest over a period of three years based on financial performance targets set for each year.

**RSUs**

The fair value of RSUs is based on the closing price of the Company's common stock on the grant date. RSUs generally vest annually over a period of two or three years from the grant date.

**Equity-based Compensation Expense**

Equity-based compensation expense was reflected in the consolidated statements of operations as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Cost of sales, buying and occupancy	\$ 152	\$ 164	\$ 546	\$ 481
Direct store expenses	215	22	580	81
Selling, general and administrative expenses	832	1,433	3,068	3,723
Equity-based compensation expense before income taxes	1,199	1,619	4,194	4,285
Income tax benefit	(480)	(620)	(1,678)	(1,684)
Net equity-based compensation expense	<u>\$ 719</u>	<u>\$ 999</u>	<u>\$ 2,516</u>	<u>\$ 2,601</u>

Net equity-based compensation expense for the thirty-nine weeks ended September 29, 2013 included additional expense of \$0.5 million related to anti-dilution provision payments made to certain option holders. See Note 11, "Stockholders' Equity" for more information. As of September 28, 2014 and December 29, 2013, there were approximately 8.1 million and 10.9 million options outstanding and 1.5 million and 2.7 million unvested options outstanding, respectively.

As of September 28, 2014 and December 29, 2013, there were approximately 0.1 million and no unvested RSUs outstanding, respectively.

As of September 28, 2014, total unrecognized compensation expense related to outstanding options was \$4.4 million which, if the service and performance conditions are fully met, is expected to be recognized over the next 1.1 years on a weighted-average basis.

As of September 28, 2014, total unrecognized compensation expense related to outstanding RSUs was \$3.2 million which, if the service conditions are fully met, is expected to be recognized over the next 2.0 years on a weighted-average basis.

During the thirty-nine weeks ended September 28, 2014, the Company received \$7.6 million in cash proceeds from the exercise of options, including a total of 2.3 million options exercised by current or former team members who sold the underlying shares in the April Secondary Offering and in the August Secondary Offering.

During the thirty-nine weeks ended September 29, 2013, the Company received \$0.1 million in cash proceeds from the exercise of options.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion of our financial condition and results of operations in conjunction with the consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K filed February 27, 2014 with the Securities and Exchange Commission. All dollar amounts included below are in thousands, unless otherwise noted.

### Business Overview

Sprouts Farmers Market, Inc. operates as a healthy grocery store that offers fresh, natural and organic food that includes fresh produce, bulk foods, vitamins and supplements, grocery, meat and seafood, bakery, dairy, frozen foods, body care and natural household items catering to consumers' growing interest in eating and living healthier. Since our founding in 2002, we have grown rapidly, significantly increasing our sales, store count and profitability. With 191 stores in ten states as of September 28, 2014, we are one of the largest specialty retailers of natural and organic food in the United States.

The cornerstones of our business are fresh, natural and organic products at compelling prices (which we refer to as "Healthy Living for Less"), an attractive and differentiated shopping experience, and knowledgeable team members who we believe provide best-in-class customer service and product education.

*Healthy Living For Less.* The foundation of our value proposition is fresh, high-quality produce which we offer at prices we believe are significantly below those of conventional food retailers and even further below high-end natural and organic food retailers. We believe that by combining our scale in and self-distribution of produce, we ensure that our produce meets our high quality standards and can be delivered to customers at market leading prices. In addition, our scale, operating structure and deep industry relationships position us to consistently deliver "Healthy Living for Less." Based on our experience, we believe we attract a broad customer base, including conventional supermarket customers, and appeal to a much wider demographic than other specialty retailers of natural and organic food. Trial visits to our stores allow us to engage with customers while showcasing our complete grocery offering and differentiated retail format. We believe that over time, our compelling prices and product offering convert many "trial" customers into loyal "lifestyle" customers who shop Sprouts with greater frequency and across an increasing number of departments.

*Attractive, Differentiated Shopping Experience.* In a convenient, small-box format (average store size of 27,500 sq. ft.), our stores have a farmers market feel, with easy-to-shop floor plans, a bright open-air atmosphere and low profile displays allowing customers to view the entire store upon entry. We design our stores to create a comfortable and engaging shopping experience supported by our well-trained and knowledgeable team members. We strive to be our customers' everyday market. We dedicate significant floor space in the center of our stores to our produce and bulk food departments which we merchandise in bountifully stacked crates and rows of self-service bins creating a farmers market environment. Produce and bulk foods at the center of the store are surrounded by a complete grocery offering, including vitamins and supplements, grocery, meat and seafood, bakery, dairy, frozen foods, beer and wine, body care and natural household items. Consistent with our natural and organic offering, we choose not to carry most of the traditional, national branded consumer packaged goods generally found at conventional grocery retailers (e.g., Doritos, Tide and Lucky Charms). Instead, we offer high-quality alternatives that emphasize our focus on fresh, natural and organic products at great values.

*Customer Service & Education.* We are dedicated to our mission of "Healthy Living for Less," and we attract team members who share our passion for educating and serving our customers with the goal of making healthy eating easier and more accessible. Our passionate and well-trained team

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members engage customers throughout the entire store and provide them with product and nutritional education. As a result, we believe our customers increasingly understand that they can purchase a wide selection of high-quality, healthy, and great tasting food for themselves and their families at attractive prices by shopping at Sprouts. Over time, we believe our customers become passionate about both Sprouts and eating healthy, and we experience growing sales as they shop Sprouts for a greater percentage of their grocery needs.

### **Outlook**

We are pursuing a number of strategies designed to continue our growth, including expansion of our store base, driving comparable store sales growth, enhancing our operating margins and growing the Sprouts brand. We intend to continue expanding our store base by pursuing new store openings in our existing markets, expanding into adjacent markets and penetrating new markets. We opened 24 stores and relocated one store during 2014. Although we plan to expand our store base primarily through new store openings, we may grow through strategic acquisitions if we identify suitable targets and are able to negotiate acceptable terms and conditions for acquisition. We intend to achieve 14% annual new store growth for at least the next five years.

We also believe we can continue to improve our comparable store sales growth by enhancing our core value proposition and distinctive customer-oriented shopping experience, as well as through expanding and refining our fresh, natural and organic product offerings, our targeted and personalized marketing efforts and our in-store education. We believe our operating margins will continue to benefit from scale efficiencies, continued cost discipline and enhancements to our merchandise offerings. We are committed to growing the Sprouts brand by supporting our stores, product offerings and corporate partnerships, including the expansion of innovative marketing and promotional strategies through print, digital and social media platforms, all of which promote our mission of "Healthy Living for Less."

### **Our History**

In 2002, we opened the first Sprouts Farmers Market store in Chandler, Arizona. In 2010, we had 54 stores and reached over \$620 million in net sales and approximately 3,700 team members. In April 2011, we partnered with investment funds affiliated with, and co-investment vehicles managed by, Apollo Management VI, L.P., and added 43 stores by merging with Henry's Holdings, LLC (referred to as "Henry's") and its Sun Harvest-brand stores. Our merger with Henry's and new store openings brought us to 103 total stores located in Arizona, California, Colorado and Texas as of the end of 2011. In May 2012, we added another 37 stores through our acquisition of Sunflower Farmers Markets, Inc. (referred to as "Sunflower") and extended our footprint into New Mexico, Nevada, Oklahoma and Utah. On August 1, 2013, our common stock began trading on the NASDAQ Global Select Market and on August 6, 2013, we closed our initial public offering (referred to as our "IPO"). Since the IPO, we have continued to expand, adding 28 stores through the date of this filing and extending to Kansas and Georgia.

### **Components of Operating Results**

We report our results of operations on a 52- or 53-week fiscal year ending on the Sunday closest to December 31, with each fiscal quarter generally divided into three periods consisting of two four-week periods and one five-week period. The third quarters of fiscal 2014 and 2013 were thirteen-week periods ended September 28, 2014 and September 29, 2013, respectively.

#### **Net Sales**

We recognize sales revenue at the point of sale, with discounts provided to customers reflected as a reduction in sales revenue. Proceeds from sales of gift cards are recorded as a liability at the time of sale, and recognized as sales when they are redeemed by the customer. We do not include sales taxes in net sales.

We monitor our comparable store sales growth to evaluate and identify trends in our sales performance. Our practice is to include sales from a store in comparable store sales beginning on the first

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day of the 61st week following the store's opening and to exclude sales from a closed store from comparable store sales beginning on the day of closure. We include sales from an acquired store in comparable store sales on the later of (i) the day of acquisition or (ii) the first day of the 61st week following the store's opening. We also include sales from relocated stores immediately after relocation. These practices may differ from the methods that other retailers use to calculate similar measures.

Net sales are affected by store openings and closings and comparable store sales growth. Factors that influence comparable store sales growth and other sales trends include:

- general economic conditions and trends, including levels of disposable income and consumer confidence;
- consumer preferences and buying trends;
- our ability to identify market trends, and to source and provide product offerings that promote customer traffic and growth in average ticket;
- the number of customer transactions and average ticket;
- the prices of our products, including the effects of inflation and deflation;
- opening new stores in the vicinity of our existing stores;
- advertising, in-store merchandising and other marketing activities; and
- our competition, including competitive store openings in the vicinity of our stores and competitor pricing and merchandising strategies.

### ***Cost of sales, buying and occupancy and gross profit***

Cost of sales includes the cost of inventory sold during the period, including direct costs of purchased merchandise (net of discounts and allowances), distribution and supply chain costs, buying costs and supplies. Merchandise incentives received from vendors are reflected in the carrying value of inventory when earned or as progress is made toward earning the rebate or allowance, and are reflected as a component of cost of sales as the inventory is sold. Inflation and deflation in the prices of food and other products we sell may affect our gross profit and gross margin. The short-term impact of inflation and deflation is largely dependent on whether or not we pass the effects through to our customers, which will depend upon competitive market conditions.

Occupancy costs include store rental, property taxes, utilities, common area maintenance, amortization of favorable and unfavorable leasehold interests and property insurance. Occupancy costs do not include building depreciation, which is classified as a direct store expense.

Our cost of sales, buying and occupancy and gross profit are correlated to sales volumes. As sales increase, gross margin is affected by the relative mix of products sold, pricing strategies, inventory shrinkage and improved leverage of fixed costs of sales, buying and occupancy.

### ***Direct store expenses***

Direct store expenses consist of store-level expenses such as salaries and benefits, related equity-based compensation, supplies, depreciation and amortization for buildings, store leasehold improvements, equipment and other store specific costs. As sales increase, direct store expenses generally decline as a percentage of sales.

### ***Selling, general and administrative expenses***

Selling, general and administrative expenses primarily consist of salaries and benefits costs, equity-based compensation, advertising and corporate overhead.

We charge third-parties to place advertisements in our in-store guide and newspaper circulars. We record consideration received from vendors in connection with cooperative advertising programs as a reduction to advertising costs when the allowance represents reimbursement of a specific and identifiable cost. Advertising costs are expensed as incurred.

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### ***Store pre-opening costs***

Store pre-opening costs include rent expense during construction of new stores and costs related to new store openings, including costs associated with hiring and training personnel and other miscellaneous costs. Store pre-opening costs are expensed as incurred.

### ***Store closure and exit costs***

We recognize a reserve for future operating lease payments and other occupancy costs associated with facilities that are no longer being utilized in our current operations. The reserve is recorded based on the present value of the remaining non-cancelable lease payments and estimates of other occupancy costs after the cease use date less an estimate of subtenant income. If subtenant income is expected to be higher than the lease payments, no accrual is recorded. Lease payments and other occupancy costs included in the closed store reserve are expected to be paid over the remaining terms of the respective leases. Our assumptions about subtenant income are based on our experience and knowledge of the area in which the closed property is located, guidance received from local brokers and agents and existing economic conditions. Adjustments to the closed store reserve relate primarily to changes in actual or estimated subtenant income and changes in actual lease payments and other occupancy costs from original estimates. Adjustments are made for changes in estimates in the period in which the change becomes known, considering timing of new information regarding market, subleases or other lease updates. Changes in reserve estimates are classified as store closure and exit costs in the consolidated statements of operations.

### ***Provision for income taxes***

Prior to our IPO, we were structured as a limited liability company, but we elected to be taxed as a corporation for income tax purposes. We are subject to federal income tax as well as state income tax in various jurisdictions of the United States in which we conduct business. Income taxes are accounted for under the asset and liability method.

On July 29, 2013, Sprouts Farmers Markets, LLC, a Delaware limited liability company, converted into Sprouts Farmers Market, Inc., a Delaware corporation, as described under “—Factors Affecting Comparability of Results of Operations—Corporate Conversion.” The corporate conversion has not had a material impact on our results of operations, financial position or cash flows since we were treated as a corporation for income tax purposes prior to the conversion.

In September 2013, the Internal Revenue Service issued final regulations related to tangible property, which govern when a taxpayer must capitalize or deduct expenses for acquiring, maintaining, repairing and replacing tangible property. The regulations are effective for tax years beginning January 1, 2014; however, early adoption is permitted. We have analyzed the impacts of the tangible property regulations, and have determined we are in compliance with the regulations. The adoption of the regulations did not have a material effect on our consolidated financial statements.

## **Factors Affecting Comparability of Results of Operations**

### ***April 2013 Refinancing***

In April 2013, we completed a transaction (referred to as the “April 2013 Refinancing”) in which we refinanced our debt by entering into a new credit facility (referred to as the “Credit Facility”) and made a distribution to our equity and option holders, as further discussed in Note 6 “Long-Term Debt” and Note 11 “Stockholders’ Equity” to our consolidated financial statements included in this Quarterly Report on Form 10-Q. The Credit Facility provides for a \$700.0 million term loan (referred to as the “Term Loan”) and a \$60.0 million senior secured revolving credit facility (referred to as the “Revolving Credit Facility”). The April 2013 Refinancing resulted in an increase in borrowings and reduction in interest rate commencing in April 2013.

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### **Corporate Conversion**

On July 29, 2013, Sprouts Farmers Markets, LLC, a Delaware limited liability company, converted into Sprouts Farmers Market, Inc., a Delaware corporation. As part of the corporate conversion, holders of Class A and Class B units of Sprouts Farmers Markets, LLC received 11 shares of our common stock for each unit held immediately prior to the corporate conversion, and options to purchase units became options to purchase 11 shares of our common stock for each unit underlying options outstanding immediately prior to the corporate conversion, at the same aggregate exercise price in effect prior to the corporate conversion. For the convenience of the reader and in accordance with GAAP in the case of the consolidated financial statements, except where the context otherwise requires, information in this Quarterly Report on Form 10-Q has been presented giving effect to the corporate conversion. The corporate conversion has not had a material impact on the comparability of our results of operation as a result of the corporate conversion, since we have been treated as a corporation for income tax purposes.

### **IPO**

On August 6, 2013, we completed our initial public offering of 21,275,000 shares of common stock of Sprouts Farmers Market, Inc., at a price of \$18.00 per share. We sold 20,477,215 shares of common stock, and certain stockholders sold the remaining 797,785 shares.

We received net proceeds from our IPO of \$344.1 million, after deducting underwriting discounts and offering expenses. We used the net proceeds to repay \$340.0 million of outstanding indebtedness under the Term Loan and the remainder for general corporate purposes.

### **Secondary Offerings**

On December 2, 2013, certain of our stockholders completed a secondary public offering of 19,550,000 shares of common stock, including 2,550,000 shares of common stock sold as a result of the exercise in full of the underwriters' option to purchase additional shares, at a price of \$37.00 per share (referred to as the "December Secondary Offering").

On April 2, 2014, certain of our stockholders completed a secondary public offering of 17,250,000 shares of common stock, including 2,250,000 shares of common stock sold as a result of the exercise in full of the underwriters' option to purchase additional shares, at a price of \$33.75 per share (referred to as the "April Secondary Offering").

On August 18, 2014, certain of our stockholders completed a secondary public offering of 17,158,191 shares of common stock, including 2,158,191 shares of common stock sold as a result of the partial exercise of the underwriters' option to purchase additional shares, at a price of \$30.00 per share (referred to as the "August Secondary Offering").

We did not sell any shares in the December, April or the August Secondary Offerings.

**Results of Operations for Thirteen Weeks Ended September 28, 2014 and September 29, 2013**

The following tables set forth our unaudited results of operations and other operating data for the periods presented. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods. All dollar amounts are in thousands, unless otherwise noted.

	Thirteen weeks ended	
	September 28, 2014	September 29, 2013
<b>Unaudited Quarterly Consolidated Statement of Operations Data:</b>		
Net sales	\$ 766,415	\$ 633,614
Cost of sales, buying and occupancy	540,367	443,509
Gross profit	226,048	190,105
Direct store expenses	148,633	129,418
Selling, general and administrative expenses	24,015	22,807
Store pre-opening costs	3,684	1,237
Store closure and exit costs	60	(38)
Income from operations	49,656	36,681
Interest expense	(6,157)	(8,790)
Other income	281	203
Loss on extinguishment of debt	(1,138)	(9,507)
Income before income taxes	42,642	18,587
Income tax provision	(16,577)	(7,126)
Net income	<u>\$ 26,065</u>	<u>\$ 11,461</u>

	Thirteen weeks ended	
	September 28, 2014	September 29, 2013
<b>Comparable store sales growth(1)</b>	9.0%	10.2%
<b>Other Operating Data:</b>		
Stores at beginning of period	177	160
Opened	14	7
Stores at end of period	<u>191</u>	<u>167</u>

(1) See the explanation of "Comparable store sales growth" above under "Components of Operating Results – Net Sales."

**Comparison of Thirteen Weeks Ended September 28, 2014 to Thirteen Weeks Ended September 29, 2013**

**Net sales**

	Thirteen weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Net sales	\$ 766,415	\$ 633,614	\$132,801	21%
Comparable store sales growth	9.0%	10.2%		

Net sales increased during the thirteen weeks ended September 28, 2014 as compared to the thirteen weeks ended September 29, 2013, primarily as a result of (i) new store openings after September 29, 2013 and (ii) sales growth at stores operated prior to September 29, 2013. New store openings after

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September 29, 2013 contributed \$68.1 million, or 51%, of the increase in net sales during the thirteen weeks ended September 28, 2014. Additionally, \$64.7 million, or 49%, of the increase came from comparable store sales growth and new store openings during fiscal 2013 not yet reflected in comparable store sales.

### **Cost of sales, buying and occupancy and gross profit**

	Thirteen weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Net sales	\$ 766,415	\$ 633,614	\$132,801	21%
Cost of sales, buying and occupancy	540,367	443,509	96,858	22%
Gross profit	226,048	190,105	35,943	19%
Gross margin	29.5%	30.0%	(0.5)%	

Cost of sales, buying and occupancy increased during the thirteen weeks ended September 28, 2014 compared to the thirteen weeks ended September 29, 2013, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. Gross profit increased \$39.8 million as a result of increased sales volume. Gross margins were lower due to lower merchandise margins from price investments in certain categories and inflation in certain categories. Those decreases were partially offset by leverage in occupancy, utilities and buying costs.

### **Direct store expenses**

	Thirteen weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Direct store expenses	\$ 148,633	\$ 129,418	\$19,215	15%
Percentage of net sales	19.4%	20.4%	(1.0)%	



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Direct store expenses increased \$19.2 million, primarily due to \$15.3 million of direct store expenses related to stores opened since September 29, 2013 and a \$3.9 million increase in direct store expenses associated with stores operated prior to the thirteen weeks ended September 29, 2013. Direct store expenses, as a percentage of net sales, decreased 100 basis points primarily due to leverage in payroll and benefits, including lower utilization of medical benefits, leverage in depreciation and store level expenses and a benefit from capitalizing a higher amount for store development costs due to the greater number of stores opened during the thirteen weeks ended September 28, 2014 over the prior year.

### ***Selling, general and administrative expenses***

	Thirteen weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Selling, general and administrative expenses	\$ 24,015	\$ 22,807	\$1,208	5%
Percentage of net sales	3.1%	3.6%	(0.5)%	

The increase in selling, general and administrative expenses included \$1.9 million for advertising expense, \$0.9 million for expenses related to the August Secondary Offering, \$0.8 million for corporate payroll to support growth and \$0.7 million for regional administration expense due to additional store count and growth into new regions; these increases were partially offset by \$3.2 million for IPO bonus in the prior year. Selling, general and administrative expenses decreased as a percent of net sales due to leveraging of corporate expenses and partially offset by higher advertising expense due to expansion into new markets.

### ***Store pre-opening costs***

Store pre-opening costs were \$3.7 million for the thirteen weeks ended September 28, 2014 and \$1.2 million for the thirteen weeks ended September 29, 2013. Store pre-opening costs in the thirteen weeks ended September 28, 2014 included \$3.6 million related to opening 14 stores during that period and \$0.1 million associated with stores opening during the next year. Store pre-opening costs in the thirteen weeks ended September 29, 2013 included \$1.1 million related to opening seven stores during that period and \$0.1 million for stores opened in the next year.

### ***Store closure and exit costs***

Store closure and exit costs for the thirteen weeks ended September 28, 2014 included a \$1.2 million favorable adjustment to reserve for settlement with a landlord, offset by changes in reserves for stores and facilities already closed and ongoing expenses related to those facilities. Additionally, we determined that we should have been recording accretion expense for store closure reserves and liability for certain occupancy costs. We made a correcting entry of \$0.9 million to adjust the liability for closed stores to include such accretion and liability for certain occupancy costs for prior periods. The effect of this entry was not material to any period. Store closure and exit costs for the thirteen weeks ended September 29, 2013 consisted of changes in reserves for stores and facilities already closed.

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### **Interest expense**

Interest expense decreased to \$6.2 million for the thirteen weeks ended September 28, 2014 from \$8.8 million for the thirteen weeks ended September 29, 2013. The decrease in interest expense is due to the lower principal balance of our Term Loan and the interest rate reduction under our Credit Facility in conjunction with our IPO.

### **Loss on extinguishment of debt**

In the thirteen weeks ended September 28, 2014, we made a voluntary principal payment of \$50.0 million and wrote-off \$1.1 million of deferred financing costs and original issue discount related to that portion of the Term Loan.

In the thirteen weeks ended September 29, 2013, in connection with the August 2013 pay down of debt using proceeds from our IPO, we recorded a loss on extinguishment of debt totaling \$9.0 million primarily related to the write-off of deferred financing costs and original issue discount. Additionally, the loss on extinguishment of debt includes \$0.5 million related to the renewal of a financing lease.

### **Income tax provision**

Income tax provision increased to \$16.6 million for the thirteen weeks ended September 28, 2014 from \$7.1 million for the thirteen weeks ended September 29, 2013, primarily related to an increase in income before income taxes. Our effective income tax rate increased to 38.9% in the thirteen weeks ended September 28, 2014 from 38.3% in the thirteen weeks ended September 29, 2013. The primary reasons for the increase in the effective tax rate were the result of a reduction in the net deferred tax asset because of a decrease in the statutory state income tax rate and a reduction in the deferred tax asset for income tax credits partially offset by provision to tax return adjustments for the 2013 income tax return. The impacts of the items noted above were recorded in the quarter.

### **Net income**

	Thirteen weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Net income	\$ 26,065	\$ 11,461	\$14,604	127%
Percentage of net sales	3.4%	1.8%	1.6%	

Net income growth was attributable to strong business performance driven by comparable store sales growth and resulting operating leverage, strong performance of new stores opened, lower loss on extinguishment of debt and reduced interest expense slightly offset by increase in advertising expense to support our growth into new markets.

**Results of Operations for Thirty-Nine Weeks Ended September 28, 2014 and September 29, 2013**

The following tables set forth our unaudited results of operations and other operating data for the periods presented. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods. All dollar amounts are in thousands, unless otherwise noted.

	Thirty-Nine weeks ended	
	September 28, 2014	September 29, 2013
<b>Unaudited Quarterly Consolidated Statement of Operations Data:</b>		
Net sales	\$ 2,232,831	\$ 1,829,675
Cost of sales, buying and occupancy	1,558,876	1,278,623
Gross profit	673,955	551,052
Direct store expenses	430,019	367,064
Selling, general and administrative expenses	69,594	60,259
Store pre-opening costs	7,051	5,254
Store closure and exit costs	393	1,670
Income from operations	166,898	116,805
Interest expense	(19,144)	(30,346)
Other income	477	447
Loss on extinguishment of debt	(1,138)	(17,682)
Income before income taxes	147,093	69,224
Income tax provision	(57,144)	(27,178)
Net income	\$ 89,949	\$ 42,046

	Thirty-Nine weeks ended	
	September 28, 2014	September 29, 2013
<b>Comparable store sales growth(1)</b>	10.4%	9.7%
<b>Other Operating Data:</b>		
Stores at beginning of period	167	148
Opened	24	19
Stores at end of period(2)	191	167

- (1) See the explanation of "Comparable store sales growth" above under "Components of Operating Results—Net Sales."  
(2) During the thirty-nine weeks ended September 28, 2014, we also relocated one store.

**Comparison of Thirty-Nine Weeks Ended September 28, 2014 to Thirty-Nine Weeks Ended September 29, 2013**

**Net sales**

	Thirty-Nine weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Net sales	\$ 2,232,831	\$ 1,829,675	\$403,156	22%
Comparable store sales growth	10.4%	9.7%		

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Net sales increased during the thirty-nine weeks ended September 28, 2014 as compared to the thirty-nine weeks ended September 29, 2013, primarily as a result of (i) sales growth at stores operated prior to September 29, 2013 and (ii) new store openings after September 29, 2013. Comparable store sales growth and new store openings during fiscal 2013 not yet reflected in comparable store sales growth contributed \$292.3 million, or 72%, of the increase in net sales during the thirty-nine weeks ended September 28, 2014. Additionally, \$110.8 million, or 28%, of the increase in net sales resulted from new store openings after September 29, 2013.

### **Cost of sales, buying and occupancy and gross profit**

	Thirty-nine weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Net sales	\$ 2,232,831	\$ 1,829,675	\$403,156	22%
Cost of sales, buying and occupancy	1,558,876	1,278,623	280,253	22%
Gross profit	673,955	551,052	122,903	22%
Gross margin	30.2%	30.1%	0.1%	

Cost of sales, buying and occupancy increased during the thirty-nine weeks ended September 28, 2014 compared to the thirty-nine weeks ended September 29, 2013, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. Gross profit increased \$121.3 million as a result of increased sales volume and \$1.6 million as a result of increased margin. The 10 basis point increase in gross margin during the thirty-nine weeks ended September 28, 2014 was primarily driven by leverage in occupancy, utilities and buying costs partially offset by lower merchandise margins from price investments in certain categories and higher inflation in certain categories.

### **Direct store expenses**

	Thirty-Nine weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Direct store expenses	\$ 430,019	\$ 367,064	\$62,955	17%
Percentage of net sales	19.3%	20.1%	(0.8)%	

Direct store expenses increased \$63.0 million, primarily due to a \$38.9 million increase for stores operated prior to the thirty-nine weeks ended September 29, 2013. The remaining \$24.1 million increase in direct store expenses is associated with stores opened since September 29, 2013. Direct store expenses, as a percentage of net sales, decreased 80 basis points, primarily due to leverage in payroll and benefits, including lower utilization of medical benefits, leverage in depreciation and store level expenses and a benefit from capitalizing a higher amount for store development costs due to the greater number of stores opened during the thirty-nine weeks ended September 28, 2014 over last year.

### **Selling, general and administrative expenses**

	Thirty-Nine weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Selling, general and administrative expenses	\$ 69,594	\$ 60,259	\$9,335	15%
Percentage of net sales	3.1%	3.3%	(0.2)%	

The increase in selling, general and administrative expenses included \$2.6 million of corporate payroll and benefits to support growth, \$2.4 million of advertising expense, \$2.3 million of secondary offering expenses including related payroll taxes, \$2.0 million of corporate bonus, \$1.4 million of regional expenses due to increased store count and expansion into new regions. These increases were partially offset by a \$3.2 million IPO bonus expense in the prior year. Selling, general and administrative expenses decreased as a percentage of net sales due to leverage in corporate expenses and partially offset by higher advertising expense due to expansion into new markets.

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### ***Store pre-opening costs***

Store pre-opening costs were \$7.1 million for the thirty-nine weeks ended September 28, 2014 and \$5.3 million for the thirty-nine weeks ended September 29, 2013. Store pre-opening costs in the thirty-nine weeks ended September 28, 2014 included \$6.8 million related to opening 24 stores and relocating one store during that period and \$0.3 million associated with stores opening after September 28, 2014. Store pre-opening costs in the thirty-nine weeks ended September 29, 2013 included \$5.3 million related to opening 19 stores during that period.

### ***Store closure and exit costs***

Store closure and exit costs for the thirty-nine weeks ended September 28, 2014 included costs related to the relocation of one store, a \$ 1.2 million favorable adjustment to reserves for settlement with landlord recorded during the thirteen weeks ended September 28, 2014, offset by changes in reserves for stores and facilities already closed and ongoing expenses related to prior closures. Additionally, we determined that we should have been recording accretion expense for store closure reserves and liability for certain occupancy costs. We made a correcting entry of \$0.9 million to adjust the liability for closed stores to include such accretion and liability for certain occupancy costs for prior periods. The effect of this entry was not material to any period. Store closure and exit costs for the thirty-nine weeks ended September 29, 2013 consisted primarily of costs to close a former Sunflower warehouse and adjustments to sublease estimates for stores and facilities already closed.

### ***Interest expense***

Interest expense decreased to \$19.1 million for the thirty-nine weeks ended September 28, 2014 from \$30.3 million for the thirty-nine weeks ended September 29, 2013. The decrease in interest expense is due to the lower principal balance of our Term Loan, the repayment of higher interest debt in the April 2013 Refinancing, the repayment of the senior subordinated notes and the interest rate reduction under our Credit Facility in conjunction with our IPO.

### ***Loss on extinguishment of debt***

In the thirty-nine weeks ended September 28, 2014, we made a voluntary principal payment of \$50.0 million and wrote-off \$1.1 million of deferred financing costs and original issue discount related to that portion of the Term Loan.

In the thirty-nine weeks ended September 29, 2013, we recorded a loss on extinguishment of debt totaling \$17.2 million related to the write-off of deferred financing costs and issue discount. These write-offs included \$9.0 million related to the August 2013 pay down of debt using proceeds from our IPO and \$8.2 million related to the April 2013 refinancing. Additionally, loss on extinguishment of debt includes \$0.5 million related to the renewal of a financing lease.

### ***Income tax provision***

Income tax provision increased to \$57.1 million for the thirty-nine weeks ended September 28, 2014 from \$27.2 million for the thirty-nine weeks ended September 29, 2013, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 38.9% in the thirty-nine weeks ended September 28, 2014 from 39.3% in the thirty-nine weeks ended September 29, 2013 due to an increase in the enhanced charitable food contribution.

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**Net income**

	Thirty-Nine weeks ended		Change	% Change
	September 28, 2014	September 29, 2013		
Net income	\$ 89,949	\$ 42,046	\$47,903	114%
Percentage of net sales	4.0%	2.3%	1.7%	

Net income growth was attributable to strong business performance driven by comparable store sales growth and resulting operating leverage, strong performance of new stores opened, lower loss on extinguishment of debt and reduced interest expense.

## Liquidity and Capital Resources

The following table sets forth the major sources and uses of cash for each of the periods set forth below, as well as our cash and cash equivalents at the end of each period:

	Thirty-Nine weeks ended	
	September 28, 2014	September 29, 2013
Cash and cash equivalents at end of period	\$ 118,447	\$ 91,735
Cash provided by operating activities	\$ 151,301	\$ 138,304
Cash used in investing activities	\$ (95,867)	\$ (74,603)
Cash provided by (used in) financing activities	\$ (14,639)	\$ (39,177)

Since inception, we have financed our operations primarily through cash generated from our operations, sales of our equity and borrowings under our current and former credit facilities. Our primary uses of cash are for purchases of inventory, operating expenses, capital expenditures primarily for opening new stores, remodel and maintenance capital expenditures, and debt service. We believe that our existing cash and cash equivalents, and cash anticipated to be generated by operations will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including new store openings, remodel and maintenance capital expenditures at existing stores, store initiatives and other corporate capital expenditures and activities. Our cash and cash equivalents position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within days from the related sale. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, results of operations and financial condition would be adversely affected.

### **Operating Activities**

Net cash provided by operating activities increased \$13.0 million to \$151.3 million for the thirty-nine weeks ended September 28, 2014 compared to \$138.3 million for the thirty-nine weeks ended September 29, 2013. The thirty-nine weeks ended September 28, 2014 includes the impact of stores opened since September 29, 2013. In addition to the increase in the number of stores we operate, we leveraged occupancy, buying, utilities and fixed direct store expenses with higher comparable store sales growth. We also experienced a decrease in interest expense due to refinancing our long-term debt, reduction in balances from a payoff made with IPO proceeds and other unscheduled voluntary repayments and lower interest rate, including a 0.5% lower rate due to our IPO.

### **Investing Activities**

Net cash used in investing activities was \$95.9 million for the thirty-nine weeks ended September 28, 2014 compared to \$74.6 million for the thirty-nine weeks ended September 29, 2013. The increase in cash used for investing activities is primarily related to timing of payments on capital expenditures for new store openings, store remodels and maintenance capital expenditures.

Capital expenditures consist primarily of investments in new stores, including leasehold improvements and store equipment, annual maintenance capital expenditures to maintain the appearance of our stores, sales enhancing initiatives and other corporate investments.

We expect capital expenditures of approximately \$110 million in fiscal 2014, net of estimated landlord tenant improvement allowances, primarily to fund investments in new stores, remodels, maintenance capital expenditures and corporate capital expenditures. We expect to fund our capital expenditures with cash on hand, cash generated from operating activities and, if required, borrowings under our Credit Facility.

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### **Financing Activities**

Net cash used by financing activities was \$14.6 million for the thirty-nine weeks ended September 28, 2014 compared to cash used in financing activities of \$39.2 million for the thirty-nine weeks ended September 29, 2013. The decrease in cash used by financing activities of \$24.6 million is related to \$295.9 million of payments to stockholders and optionholders in 2013, \$35.0 million in payments on senior subordinated notes in 2013, a \$30.6 million increase of excess tax benefits from the exercise of stock options and payments to optionholders, a \$7.5 million increase in proceeds from the exercise of stock options, a \$4.2 million payment of IPO costs in 2013, a \$1.7 million decrease in payments, including a \$50.0 million voluntary payment during the thirteen weeks ended September 28, 2014 on our term loan, net of borrowings, and a \$1.4 million payment of deferred financing costs in 2013. These decreases in cash used by financing activities were offset by \$348.3 million proceeds from the issuance of shares in 2013 and a decrease of \$3.5 million in cash from landlords related to financing lease obligations.

### **Long-Term Debt and Credit Facilities**

See Note 6 "Long-Term Debt" of our unaudited consolidated financial statements for a description of the April 2013 Refinancing and our Credit Facility.

### **Contractual Obligations**

We are committed under certain capital leases for the rental of certain buildings and land and certain operating leases for rental of facilities and equipment. These leases expire or become subject to renewal clauses at various dates through 2032.

The following table summarizes our lease obligations as of September 28, 2014, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years (in thousands)	4-5 Years	More Than 5 Years
Capital and financing lease obligations(1)	\$ 156,401	\$ 15,113	\$ 30,715	\$ 30,614	\$ 79,960
Operating lease obligations(1)	1,101,360	83,281	194,804	194,852	628,423
<b>Totals</b>	<b>\$1,257,761</b>	<b>\$ 98,394</b>	<b>\$225,519</b>	<b>\$225,466</b>	<b>\$708,383</b>

(1) Represents estimated payments for capital and financing and operating lease obligations as of September 28, 2014. Capital and financing lease obligations and operating lease obligations are presented gross without offset for subtenant rentals. We have subtenant agreements under which we will receive \$1.2 million for the period of less than one year, \$2.1 million for years one to three, \$1.4 million for years four to five, and \$2.1 million for the period beyond five years.

We have other contractual commitments and debt, which were presented under Contractual Obligations in our Annual Report on Form 10-K for the fiscal year ended December 29, 2013, and for which there have not been material changes since that filing.

### **Off-Balance Sheet Arrangements**

We do not engage in any off-balance sheet financing activities, nor do we have any interest in entities referred to as variable interest entities.



### **Impact of Inflation**

Inflation and deflation in the prices of food and other products we sell may affect our sales, gross profit and gross margin. The short-term impact of inflation and deflation is largely dependent on whether or not the effects are passed through to our customers, which is subject to competitive market conditions.

Food inflation and deflation is affected by a variety of factors and our determination of whether to pass on the effects of inflation or deflation to our customers is made in conjunction with our overall pricing and marketing strategies. Although we may experience periodic effects on sales, gross profit and gross margins as a result of changing prices, we do not expect the effect of inflation or deflation to have a material impact on our ability to execute our long-term business strategy.

### **Seasonality**

Our business is subject to modest seasonality. Our average weekly sales fluctuate throughout the year and are typically highest in the first half of the fiscal year. Produce, which contributed approximately 26% of our net sales for the thirty-nine weeks ended September 28, 2014, is generally more available in the first six months of our fiscal year due to the timing of peak growing seasons.

### **Critical Accounting Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, cash flow and related disclosure of contingent assets and liabilities. Our estimates include, but are not limited to, those related to inventory, lease assumptions, self-insurance reserves, sublease assumptions for closed stores, goodwill and intangible assets, impairment of long-lived assets, fair values of equity-based awards and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

There have been no substantial changes to these estimates or the policies related to them during the thirty-nine weeks ended September 28, 2014. For a full discussion of these estimates and policies, see "Critical Accounting Estimates" in Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 29, 2013.

### **Recently Issued Accounting Pronouncements**

See Note 2 to our accompanying unaudited consolidated financial statements contained in this Quarterly Report on Form 10-Q.

We have determined that all other recently issued accounting standards will not have a material impact on our financial statements, or do not apply to our operations.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

As described in Note 6, "Long-Term Debt" to our consolidated financial statements located elsewhere in this Quarterly Report on Form 10-Q, we have a Term Loan that bears interest at a rate based in part on LIBOR, the Federal Funds Rate, the Eurodollar Rate or the prime rate, depending on our consolidated leverage ratio. Accordingly, we are exposed to fluctuations in interest rates. Based on the \$263.0 million principal outstanding under our Term Loan as of September 28, 2014, each hundred basis point change in LIBOR, once LIBOR exceeds the LIBOR floor under our loan of 1.00%, would result in a change in interest expense by \$2.6 million annually.

This sensitivity analysis assumes our mix of financial instruments and all other variables will remain constant in future periods. These assumptions are made in order to facilitate the analysis and are not necessarily indicative of our future intentions.

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**Item 4. Controls and Procedures.**

***Evaluation of Disclosure Controls and Procedures***

We maintain a system of disclosure controls and procedures (as defined in Rules 13a- 15(e) and 15d- 15(e)) designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to our management, including our Chief Executive Officer (our principal executive officer) and our Chief Financial Officer (our principal financial officer), as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures under the Exchange Act as of September 28, 2014, the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were not effective because, as of September 28, 2014, we continued to have a material weakness related to our internal controls with respect to costing of non-perishable inventories, which we are currently addressing through the implementation of the new automated system for the calculation of inventory cost on a per unit basis. The Company is currently testing the new system and the ongoing effectiveness of the new controls. The material weakness cannot be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively.

***Changes in Internal Control Over Financial Reporting***

During the quarterly period ended September 28, 2014, there were no changes in our internal controls over financial reporting that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

**PART II—OTHER INFORMATION**

**Item 1. Legal Proceedings.**

From time to time we are a party to legal proceedings, including matters involving personnel and employment issues, product liability, personal injury, intellectual property and other proceedings arising in the ordinary course of business, which have not resulted in any material losses to date. Although management does not expect that the outcome in these proceedings will have a material adverse effect on our financial condition or results of operations, litigation is inherently unpredictable. Therefore, we could incur judgments or enter into settlements of claims that could materially impact our results.

**Item 1A. Risk Factors.**

*Certain factors may have a material adverse effect on our business, financial condition and results of operations. You should carefully consider the risks and uncertainties referenced below, together with all of the other information in this Quarterly Report on Form 10-Q, including our consolidated financial statements and related notes. Any of those risks could materially and adversely affect our business, operating results, financial condition, or prospects and cause the value of our common stock to decline, which could cause you to lose all or part of your investment.*

There have been no material changes to the Risk Factors described under “Part I – Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 29, 2013.

**Item 6. Exhibits.**

<u>Exhibit Number</u>	<u>Description</u>
10.1†	Amended and Restated Nature's Best Distribution Agreement, dated as of August 13, 2014
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

† Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment submitted separately to the Securities and Exchange Commission pursuant to Rule 406 under the Securities Act.



**EXHIBIT INDEX**

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**Section 2: EX-10.1 (EX-10.1)**

**Exhibit 10.1**

*A request for confidential treatment has been made with respect to portions of the following document that are marked with [**\*CONFIDENTIAL\***]. The redacted portions have been filed separately with the SEC.*

**AMENDED AND RESTATED**

**DISTRIBUTION AGREEMENT**

This Amended and Restated Distribution Agreement ("Agreement"), is made and entered into as of August 13, 2014 (the "Effective Date"), by and between Sprouts Farmers Market, Inc. ("SFM"), a Delaware corporation, and Nature's Best ("NB"), a California corporation.

RECITALS

I. SFM and NB entered into a Distribution Agreement ("Distribution Agreement") effective as of April 14, 2010, as amended, for the distribution of natural and organic products to all of SFM's retail stores.

II. SFM and NB wish to clarify the scope of their current business relationship that will enable both organizations to plan and implement future distribution logistics to support SFM's growth.

III. In consideration of the mutual covenants set forth herein and other good and valuable consideration, the receipt of which is hereby acknowledged, the parties hereto mutually agree that the Distribution Agreement is hereby amended and restated in its entirety, as follows:

**ASSUMPTIONS**

A. SFM is primarily engaged in the sale of natural and organic products in a ranch market format. Its operations include retail stores and distribution centers. SFM currently operates in several regions, including Arizona, California, Nevada, New Mexico, Utah, Georgia, Kansas, Texas, Oklahoma and Colorado.

B. NB provides the distribution of natural and organic products to all SFM stores. NB also provides various customized support services (Special Services — see [Exhibit A](#)) to SFM's headquarters, tailored to SFM's operations.

C. The parties desire to enter into this Agreement to set forth the terms upon which NB will sell and distribute to SFM locations and SFM locations will purchase these goods and services.

**NOW, THEREFORE**, the parties agree as follows:

- 1) **TERM:** This Agreement shall have a term of eight years commencing as of April 14, 2010.

2) **DISTRIBUTION AGREEMENT:**

- a. SFM Distribution: SFM will continue to self-distribute produce to its stores, with the objective of maintaining quality produce expertise. SFM will also continue to purchase and distribute certain other commodities that, from time to time are compatible with, and complement, SFM produce operations. Current examples include [**CONFIDENTIAL**] custom bulk products, key bulk commodities and strategic buys.

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- b. **NB Distribution:** NB will be SFM's Primary Supplier for all remaining natural product stock keeping units (SKUs) that are not direct-store delivered. NB will provide the distribution of *selectable*, defined as slotted and picked from inventory, SKUs, which will enable SFM to capitalize on NB's system to realize the overall lowest product cost.
- c. **Primary Supplier:** Shall be defined as:
  - i. All SFM stores will order a **[\*CONFIDENTIAL\*]** of their distributor-sourced organic and natural purchases from NB, which shall be subject to NB meeting the required fill rate pursuant to Section 3(c) below. Other than products distributed through its distribution facilities, SFM will source **[\*CONFIDENTIAL\*]** natural and organic products carried in SFM stores, if available from NB, through NB in the following SFM Categories: **[\*CONFIDENTIAL\*]**.
  - ii. SFM will maintain a **[\*CONFIDENTIAL\*]**, (current purchase average for stores operating at least 3 months), adjusted annually according to changes in the Consumer Price Index.
  - iii. If SFM elects to move their private label items into distribution at NB, the minimum referenced in section 2(c)(ii) will be adjusted upward by **[\*CONFIDENTIAL\*]**.
  - iv. **New Regions:** If SFM opens locations beyond the states in which NB currently supplies SFM stores, and NB does not currently service those regions, NB will have a **[\*CONFIDENTIAL\*]** (measured from the opening of the first SFM store in that state) to establish distribution for SFM in that area. SFM has the option to utilize another distributor for these locations **[\*CONFIDENTIAL\*]**. SFM and NB shall work in good faith to ensure that the cost plus rates for new regions are aligned with the current cost plus rates referenced in Exhibit D hereto based on comparable distances and logistics from servicing distribution center(s) to the new region's stores and as reasonably acceptable to SFM. In other words, the cost plus rate for any new region (excluding Alaska and Hawaii) shall not be higher than the highest applicable cost plus rate for the annualized purchases/plateau level applicable at the time of opening a store in such new region. For sake of clarity and by way of example, if at the time of opening a store in a new region (excluding Alaska and Hawaii) SFM's annualized purchases are \$711,000,000 (i.e., Plateau Level 70), then the highest cost plus rate for that region shall not exceed **[\*CONFIDENTIAL\*]**  
If NB supplies a new region's store(s) via NB's existing distribution center(s), and SFM's distribution system is utilized for delivery, NB will pay SFM a cross-dock allowance **[\*CONFIDENTIAL\*]**.  
If SFM exercises its option to utilize another distributor in a new region for an interim period **[\*CONFIDENTIAL\*]** as specified above, **[\*CONFIDENTIAL\*]**. SFM will make a good faith effort to negotiate the best rate possible from that temporary supplier to mitigate the impact.

3) **NB SUPPLIER PERFORMANCE:**

- a. **New Products:**
  - i. NB will stock all new products that are specifically requested by SFM and are placed chain wide (all SFM stores).
  - ii. Regional product requests will be stocked if carried by all stores in the region, and there are reasonable aggregate product turns.
- b. **Accuracy:** NB shall maintain an average of 99% or better order selection accuracy rate.
- c. **In-Stock Level:** NB and SFM will continue their mutual efforts to eliminate the causes of out-of-stock product in order to maintain the highest fill rate possible.
  - i. NB will utilize its commercially reasonable efforts to maintain an NB controlled in-stock level of at least 97% ("Minimum Fill Rate"), **[\*CONFIDENTIAL\*]**.
  - ii. NB will continue its current practice of reporting to SFM in-stock service levels each week. At the end of each calendar month, NB will provide SFM a monthly summary of in-stock service levels for such calendar month. In the event the average NB controlled in-stock level for such calendar month, measured on a company-wide basis, does not meet the 97% Minimum Fill Rate (referred to as a "deficiency"), SFM shall notify NB (by no later than **[\*CONFIDENTIAL\*]** after SFM's receipt of NB's monthly summary) and NB shall use its commercially reasonable efforts to cure the deficiency by **[\*CONFIDENTIAL\*]**. The reported in-stock service level shall be rounded to the nearest whole number. By way of example to illustrate the preceding sentence, a decimal figure of 0.5 or higher shall be rounded up and a decimal figure less than 0.5 shall be rounded down.
  - iii. If NB does not cure the deficiency by the end of the next calendar month (measured by satisfaction of the Minimum Fill Rate for such next calendar month), SFM shall have the right to use another distributor to meet SFM's demands, and the option to provide NB a material breach notice to be delivered by no later than **[\*CONFIDENTIAL\*]** after SFM's receipt of NB's monthly summary for such next calendar month.
  - iv. If a material breach notice is provided under this section, NB shall have an additional calendar month ("Second Calendar Cure Month") to cure the deficiency (measured by satisfaction of the Minimum Fill Rate for the Second Calendar Cure Month). If the deficiency is not cured by the end of the Second Calendar Cure Month, SFM shall then have the option to terminate this Agreement by written notice to NB by no later than **[\*CONFIDENTIAL\*]** after SFM's receipt of NB's monthly summary for the Second Calendar Cure Month. In the event this Agreement is terminated by SFM pursuant to this Section 3)c.iv., both SFM and NB agree to work in good faith to execute an orderly transition of business to SFM's designated new primary supplier that fairly treats both SFM and NB.



A request for confidential treatment has been made with respect to portions of the following document that are marked with **[\*CONFIDENTIAL\*]**. The redacted portions have been filed separately with the SEC.

- v. If the average monthly in-stock level falls below **[\*CONFIDENTIAL\*]** at any point during the term of this Agreement, SFM shall have the rights afforded under paragraph iii above.
- vi. If the average monthly in-stock level for any NB distribution facility falls below the Minimum Fill Rate, NB shall have the option to use another of its distribution facilities to cover the gap in the fill rate, at no additional cost to SFM. If using another distribution facility is not feasible or will not remedy the gap in the fill rate, then SFM shall have the right to use another distributor to meet its demands until such time as NB has cured the deficiency.

4) **TEXAS DISTRIBUTION CENTER:**

In order to support SFM's growth, NB will open a distribution center in Texas by mid-year, 2011, which the parties acknowledge has been done.

5) **NB SPECIAL SERVICES:**

NB will continue to provide SFM with customized support services. See Special Services — Exhibit A. NB will add support services from time to time as deemed appropriate by both companies, as has been past practice.

6) **PROMOTION ASSISTANCE ALLOWANCE:**

At the end of each calendar quarter NB will pay SFM a Promotion Assistance Allowance of **[\*CONFIDENTIAL\*]**. This allowance will be paid by check to SFM on a quarterly basis at the close of each calendar quarter.

7) **COST PLUS RATE:**

From and after December 30, 2013, the effective cost plus rate under which the parties shall operate in regard to the distribution of products is set forth in Exhibit D hereto.

8) **PRIVATE LABEL:**

- a. Pricing. SFM will be billed at the **[\*CONFIDENTIAL\*]**. Pricing shown on Cost Plus Program — Exhibit D.
- b. Stocking of Private Label. NB agrees to stock all SFM private label products carried by SFM and provide them to all SFM stores. In order to provide fresh and saleable private label product in new regions, it is necessary for NB to transfer certain private label items from existing NB distribution center(s) to the distribution center serving the new region. Continuing current practice, when SFM's movement on private label products in new regions is insufficient for direct delivery by the vendor to the NB distribution center, the cost plus pricing for those products will be adjusted to reflect the inter-facility transfer cost.

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- c. Special Situations. The SFM private label team will work in good faith with the NB private label team to proactively address slow turning skus of private label items in order to minimize the operational and financial impact on NB of slow turning private label items.
- d. Code Date Management. The following shall be the private label management practices NB and SFM will continue to employ in order to manage private label inventory:
  - i. NB shall provide SFM a weekly private label inventory report showing expiration dates and time remaining for all private label inventories in each facility. Items are shown in aging format with breakouts of 30, 60, 90, and 120 or more days' code date life remaining. This provides the opportunity for SFM and NB to manage close-coded private label items through special promotions and proactive distribution to SFM stores while the product is still saleable.
  - ii. The above procedures are aimed to minimize losses due to short-coded or past code private label inventory. In the event private label inventory is required to be discarded, SFM shall notify NB to remove the product from inventory and **[\*CONFIDENTIAL\*]**.
  - iii. In the event NB fails to notify SFM of a private label's item short-code status at least 30 days prior to its expiration date, resulting in the private label item being discarded due to it reaching the end of its code date life, **[\*CONFIDENTIAL\*]**.
- e. Responsibilities: SFM will negotiate directly with the manufacturer for all new private label items. NB will provide the purchasing and distribution functions.
- f. Discontinued Private Label: NB will purchase and stock all private label items in good faith to SFM's needs. **[\*CONFIDENTIAL\*]**. Existing, successful coordination will continue between SFM and NB buyers to minimize product loss.

9) **CONTROL LABEL PRODUCTS:**

Pricing: NB will purchase and stock Control Label Products under the same terms and conditions as the SFM private label above.

10) **CROSS DOCK PALLETS:** See Exhibit C.

- a. NB will, from time to time at SFM request, ship product by means of cross-docking. Cross-dock shipments will be subject to specific parameters Exhibit C). NB will bill SFM the following per pallet charge:
  - i. Pallet Charges
    - 1. California and Arizona -**[\*CONFIDENTIAL\*]**
    - 2. Texas - **[\*CONFIDENTIAL\*]** (NB warehouse handling only)

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3. Colorado - **[\*CONFIDENTIAL\*]**

- ii. The above pallet charges will be adjusted on January 1 each year by the percentage movement of the Consumer Price Index.

11) **FUEL SURCHARGE (FSC):**

At the end of each calendar month, NB will provide a monthly report of the number of deliveries by store to SFM. SFM will be invoiced at **[\*CONFIDENTIAL\*]** of the fuel surcharge specified in Exhibit B. SFM may audit the fuel surcharge billed at any time by referencing the average price per gallon of diesel fuel at: <http://tonto.eia.doe.gov/oog/info/wohdp/diesel.asp>.

12) **PALLETS, TOTES, TRANSASFES:**

- a. NB Deliveries: At the time of delivery SFM stores will return all totes from their prior delivery. They will also exchange a number of pallets equal to the amount received on their current delivery.
- b. NB Facility Pickup: SFM will exchange, by periodic return shipments to the corresponding NB distribution center(s), a quantity of pallets equal to the amount loaded on outbound pickups. Pallet counts will be reconciled monthly to ensure an even exchange.
- c. Transafes: In order to minimize the outstanding transafe inventory, SFM will continue to coordinate with NB to expedite the return of all transafes, per current practice.

13) **NEW STORE OPENINGS:**

- a. In addition to the special services outlined in Exhibit A for new openings, all opening order invoices will be incorporated into a side note with 13 equal weekly payments; starting the first week after the final opening order shipment.

14) **SERVICE LEVEL ARRANGEMENT:**

- a. NB and SFM agree to the terms set forth in Exhibit F hereof regarding processing of credits, quality control and service levels. Exhibit F forms an integral part of this Agreement.

15) **CONFIDENTIALITY:**

- a. Both SFM and NB agree to keep all terms of this Agreement strictly confidential.
- b. In the process of making this Agreement, both parties may also have acquired or developed confidential information relating to each party's businesses that includes quality standards, business methods, sales data and trends, intellectual property, purchasing history, pricing, marketing and pricing strategies, technical data, and general or specific customer information. Each party agrees to maintain this information as confidential.

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16) **COMPLIANCE WITH LAWS:**

- a. General: Each party covenants and agrees during the term of this Agreement it will fully comply with all applicable laws, ordinances, regulations, licenses and permits of or issued by any federal, state or local government entity, agency or instrumentality applicable to its responsibilities hereunder. Each party agrees that it shall comply with all certification procedures and regulations. Each party shall promptly notify the other party after it becomes aware of any material adverse proposed law, regulation or order that, to its knowledge, may or does conflict with the parties' obligations under this Agreement. The parties will then use reasonable efforts to promptly decide whether a change may be made to the terms of this Agreement to eliminate any such conflict or impracticability.

17) **TERMINATION PROVISION:**

- a. Either party may terminate this Agreement immediately by providing written notice to the other party for a material breach of any obligations under the Agreement, and failure to cure such breach after [**\*CONFIDENTIAL\***] days' prior written notice of the breach.
- b. SFM may terminate this Agreement for cause if the quality of service provided by NB does not meet industry standards, and Nature's Best fails to substantially remedy the service within [**\*CONFIDENTIAL\***] days of written notice by SFM.

18) **MISCELLANEOUS:**

- (a) Binding Effect: As of the Effective Date, this Agreement, including its exhibits, supersedes all prior agreements between SFM and NB and constitutes the only agreement between SFM and NB, either oral or in writing, relating to the subject matter hereof.
- (b) Force Majeure: "Force Majeure" events shall be events beyond the reasonable control of a party (and not through the fault or negligence of such party) that make timely performance of an obligation not possible, in which event the time for performance of the obligation affected by the event of Force Majeure shall be extended by the period of Force Majeure. Force Majeure events are those that are not reasonably foreseeable with the exercise of reasonable care, nor avoidable through the payment of nonmaterial additional sums. In the event of a Force Majeure, the party so affected shall give prompt written notice to the other party of the cause and shall take whatever reasonable steps are necessary to relieve the effect of such cause as rapidly as possible. The provisions of this section shall not apply to the financial obligations of either party to this Agreement.
- (c) Governing Law; Forum and Jurisdiction; Waiver of Punitive and Similar Types of Damages: The relationship of the parties hereto and all claims arising out of or related to that relationship, including, but not limited to, the construction and interpretation of any written agreements, including this Agreement, shall be governed by the substantive laws of the State of California (without regard to conflicts of law principles). The parties agree and consent to the jurisdiction of the state and federal courts located in Orange County, California and acknowledge

that such courts are proper and convenient forums for the resolution of any actions between the parties with respect to the subject matter of this Agreement, and agree that, in such case, these courts shall be the sole and exclusive forums for the resolution of any actions between the parties with respect to the subject matter hereof. The parties hereby waive any right to a jury trial under any applicable law. The parties also waive any and all right to punitive, incidental or consequential damages, except in the case an action is brought for breach of provisions relating to confidential information. The prevailing party in any action to enforce this Agreement shall be entitled to recover all related costs of the suit, including reasonable attorneys' fees and court costs.

- (d) Amendment; Assignment: This Agreement may not be amended or modified except by a writing signed by an authorized officer of each party specifically referencing this Agreement and the intent to amend or modify.
- (e) Change of Control: The parties hereto agree that all of the provisions of this Agreement shall bind and inure to the benefit of the parties hereto and their respective heirs, legal representatives, successors and assigns, including but not limited to, a Change of Control. A "Change of Control" means (A) any transaction or series of related transactions in which a party or group, acting in concert, acquires beneficial ownership of more than 50% of the equity interests in a party or its direct or indirect parent, or (B) a merger or consolidation of another entity with or into a party or its direct or indirect parent, with the effect that any third party becomes beneficial owner of more than 50% of the equity interests of a party or its direct or indirect parent. A Change of Control does not include the internal transfer of shares within a family structure for family planning reasons.
- (f) Entire Agreement; Survival: All exhibits to this Agreement are incorporated by reference. This Agreement (and any documents referred to herein) represents the entire agreement and understanding of the parties with respect to the matters set forth herein, and there are no representations, warranties or conditions or agreements (other than implementing invoices, purchase orders and the like necessary to implement this Agreement) not contained herein that constitute any part hereof or that are being relied upon by any party hereunder.
- (g) Severability: If any provision of this Agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the remaining provisions shall be enforced.
- (h) Notices: Unless otherwise stated, all notices given in connection with this Agreement will be in writing and will be deemed delivered at the time of personal delivery or 3 business days after being sent by facsimile (with a confirmation) or mailed by express, certified or registered mail, or sent by a recognized national or international courier, as appropriate (in all cases postage prepaid and return receipt requested). Notices shall be addressed to the parties at the addresses set forth below or to such other address as shall have been so notified to the other party in accordance with this section. Notices to NB shall be addressed to: Chief Financial Officer, Nature's Best, 6 Pointe Drive, Suite 300, Brea, California 92821. Notices to SFM shall be addressed to: Chief Operational Officer, Sprouts Farmers Market, 11811 N. Tatum Blvd., Suite 2400, Phoenix, Arizona 85028.

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Signatures: next page

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**WHEREAS**, the parties have entered into this Agreement as of the Effective Date.

By: /s/ Doug Sanders  
Signature

Doug Sanders  
Print Name

8/13/14

Doug Sanders  
President and Chief Executive Officer  
Sprouts Farmers Market, Inc.

/s/ James A. Beck  
Signature

James A. Beck  
Print Name

8/13/2014

Jim Beck  
CEO  
Nature's Best

**Exhibit A**  
**NB Special Services**

- a. SFM Account Manager at SFM's corporate office - Interacts with SFM procurement team. Serves as a local communications liaison for SFM's needs.
- b. SFM Account Specialists - **[\*CONFIDENTIAL\*]** managing contract pricing, new item coordination, promotion administration, supplier billing and SFM special needs.
- c. Business Analysis - Lead analyst point person backed up by junior analyst team. Provide analytical support to the NB and SFM procurement teams.
- d. IT Support - Director of IT and Senior Project Manager as point person.
- e. Category Management - NB provides SFM **[\*CONFIDENTIAL\*]** annually via monthly payments of **[\*CONFIDENTIAL\*]** for a **[\*CONFIDENTIAL\*]**.
- f. Merchandising Support - **[\*CONFIDENTIAL\*]** dedicated merchandising specialists backed up by NB Retail Services Team.
- g. NB Service Center - Provides immediate service to the SFM stores and serves as backup to the SFM key account team.
- Billing Services: In the case of items and vendors for which NB is primary supplier to SFM, NB provides a courtesy billing service on behalf of SFM for vendors participating in SFM's business development and merchandising programs. Written agreements are made between SFM and the vendor whereby the vendor agrees to a deduction by NB for an agreed upon participation amount.
  - These billings are predicated on NB receiving appropriate documentation of the vendor authorized billing amount, a sufficient accounts payable balance with the vendor, and such vendor still operating and doing business with SFM and NB **[\*CONFIDENTIAL\*]**. Once a sufficient balance is available for offset, **[\*CONFIDENTIAL\*]**. Any billings subsequently rejected by the vendor, bankruptcy court or other legal proceedings are billed back to SFM.
  - Billings are currently being processed for **[\*CONFIDENTIAL\*]**.
- Private Label Management: NB supports SFM's private label program through a support team in the NB purchasing department. This includes a procurement specialist who purchases SFM's private label products and functions as a single-point contact for SFM's private label manager.



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**Exhibit B  
Fuel Surcharge Schedule**

Price Per Gallon*	FUEL SURCHARGE (FSC)
\$2.25	[*CONFIDENTIAL*]
\$2.38	[*CONFIDENTIAL*]
\$2.50	[*CONFIDENTIAL*]
\$2.63	[*CONFIDENTIAL*]
\$2.75	[*CONFIDENTIAL*]
\$2.88	[*CONFIDENTIAL*]
\$3.00	[*CONFIDENTIAL*]
\$3.13	[*CONFIDENTIAL*]
\$3.25	[*CONFIDENTIAL*]
\$3.38	[*CONFIDENTIAL*]
\$3.50	[*CONFIDENTIAL*]
\$3.63	[*CONFIDENTIAL*]
\$3.75	[*CONFIDENTIAL*]
\$3.88	[*CONFIDENTIAL*]
\$4.00	[*CONFIDENTIAL*]
\$4.13	[*CONFIDENTIAL*]
\$4.25	[*CONFIDENTIAL*]
\$4.38	[*CONFIDENTIAL*]
\$4.50	[*CONFIDENTIAL*]
\$4.63 and above	[*CONFIDENTIAL*]

\* FSC adjusted monthly based on the average price per gallon during the prior calendar month Department of Energy Weekly U.S. National Average Retail On-Highway Diesel Price; published at <http://tonto.eia.doe.gov/oog/info/wobdp/diesel.asp>. FSC applied per delivery.

**Exhibit C**  
**Cross Dock Parameters**

FULL PALLETS:

1. Vendor electronic ASN (weight, cube, case, pallet counts per destination) by 5:00 PM prior day.
2. No mixed pallets handled by NB drivers at deliver point.
  - a. Note: mixed pallets ok if SFM DC is the destination and segregation is done at SFM DC by SFM personnel.
3. Regular weekly activity (enables logistics planning).
4. Delivery to Chino by 10:00 a.m. on the day of the scheduled evening loading shift.
5. Pallets clearly identified with SFM store #, address (matching ASN data).
6. Subject to space availability on truck; default to next scheduled delivery. SFM option to have shipped LTL and billed to SFM and/or vendor if critical.
7. Must be food compatible product.
8. Applies to non-produce pallets.

**Exhibit D  
Cost Plus Program**

**Cost Plus Schedule Extension**

**December 2013**

Plateau Level	Annualized Purchases (Millions)	CA Cost Plus %	AZ, NV, UT Cost Plus %	TX, OK Cost Plus %	CO, NM Cost Plus %	KS Cost Plus %	GA Cost Plus %
34	353	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
35	361	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
36	369	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
37	377	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
38	385	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
39	393	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
40	401	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
41	411	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
42	421	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
43	431	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
44	441	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
45	451	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
46	461	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
47	471	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
48	481	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
49	491	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
50	501	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
51	511	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
52	521	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
53	531	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
54	541	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
55	551	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
56	561	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
57	571	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
58	581	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
59	591	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
60	601	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
61	612	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
62	623	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
63	634	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
64	645	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
65	656	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
66	667	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
67	678	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
68	689	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
69	700	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
70	711	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]

A request for confidential treatment has been made with respect to portions of the following document that are marked with [\*CONFIDENTIAL\*]. The redacted portions have been filed separately with the SEC.

Plateau Level	Annualized Purchases (Millions)	CA	AZ, NV, UT	TX, OK	CO, NM	KS	GA
		Cost Plus %	Cost Plus %	Cost Plus %	Cost Plus %	Cost Plus %	Cost Plus %
71	722	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
72	733	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
73	744	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
74	755	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
75	766	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
76	777	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
77	788	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
78	799	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
79	810	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
80	822	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
81	834	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
82	846	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
83	858	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
84	870	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
85	882	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
86	894	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
87	906	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
88	918	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
89	930	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
90	942	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
91	954	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
92	966	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
93	978	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
94	990	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
95	1,002	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
96	1,014	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
97	1,026	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
98	1,038	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
99	1,050	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
100	1,062	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
101	1,074	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
102	1,086	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
103	1,098	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
104	1,110	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
105	1,122	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
106	1,134	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
107	1,146	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
108	1,158	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
109	1,170	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
110	1,182	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
111	1,194	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
112	1,206	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]

A request for confidential treatment has been made with respect to portions of the following document that are marked with **[\*CONFIDENTIAL\*]**. The redacted portions have been filed separately with the SEC.

Plateau Level	Annualized Purchases (Millions)	CA	AZ, NV, UT	TX, OK	CO, NM	KS	GA
		Cost Plus %	Cost Plus %	Cost Plus %	Cost Plus %	Cost Plus %	Cost Plus %
113	1,218	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
114	1,230	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
115	1,242	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
116	1,254	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
117	1,266	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
118	1,278	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
119	1,290	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
120	1,302	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
121	1,314	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
122	1,326	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
123	1,338	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
124	1,350	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
125	1,362	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
126	1,374	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
127	1,386	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
128	1,398	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
129	1,410	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
130	1,422	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
131	1,434	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
132	1,446	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
133	1,458	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
134	1,470	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
135	1,482	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
136	1,494	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]
137	1,506	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]	[*CONFIDENTIAL*]

Should Nature's Best acquire or open a distribution center in a new region, and stores are transferred to be serviced by that new distribution center, the cost plus rate for the transferred stores will be revised to reflect the distance from the new distribution center.

**VOLUME REVIEW:** Rate adjusted (if applicable) on the 15th of the month following each completed calendar quarter.

**TERMS:** 7 Days ACH

Exhibit F

CREDITS; QUALITY CONTROL; SERVICE LEVELS

**I. CREDITS:**

- A. Credit Allowance: In order to eliminate the resources and administrative cost associated with SFM stores calling in and managing individual item credits, and NB researching and processing them, NB and SFM have implemented a credit allowance. This allowance is established to compensate stores for routine occurrences of mis-picked items, item shortages and damaged products. SFM is credited monthly for this allowance based on **[\*CONFIDENTIAL\*]**.
- B. Exceptions: Notwithstanding the credit allowance above, a credit request may be called into NB's Service Center when the following occurs ("Exception" or "Exceptions"):
- a. A shipment involving excessive shortages or damaged product involving the following:
    - i. Over **[\*CONFIDENTIAL\*]** cases of any individual sku is shorted or damaged on the delivery.
    - ii. **[\*CONFIDENTIAL\*]** pallet(s) or tote(s) are missing from the delivery.
    - iii. Over **[\*CONFIDENTIAL\*]** in cost value for any individual sku is shorted or damaged on the delivery.
  - b. Product is shipped out-of-code (private label and control brand items allocated to the stores by SFM's support office do not apply). Must be called in within **[\*CONFIDENTIAL\*]** of delivery.
  - c. Manufacturer product recalls.
  - d. Infested product. Must be called in within **[\*CONFIDENTIAL\*]** of delivery.
  - e. Highly perishable products (yogurts, eggs, kefir, sour cream, cottage cheese, fluid milk) expiring within **[\*CONFIDENTIAL\*]** of invoice date upon delivery. Must be called in within **[\*CONFIDENTIAL\*]** of delivery. Private label items are not eligible for call in.

Should any of these exceptions occur, a store team member is directed to call into the NB Service Center and provide details of the credit request and invoice number. NB researches and handles these credit exception requests directly with the individual store as appropriate based on the results of this research.

No credits outside of the Exceptions will be accepted. SFM stores will NOT be permitted to submit credits for products that are damaged or go out of code post-delivery. SFM team members abusing the credit policy will be subject to disciplinary action accordingly.

- C. Texas Cross-Dock Allowance: In addition to the Credit Allowance described above, the following Texas stores shall receive a cross-dock allowance/credit of **[\*CONFIDENTIAL\*]**.

## II. SERVICE LEVELS:

- A. Service and Support. The following are hereby added to the Distribution Agreement:
- a. NB shall provide products consistent with industry standards in the volumes requested by SFM subject to all terms and conditions of this Agreement.
  - b. NB currently provides the support services outlined in Exhibit A to this Agreement, and will continue to adjust its services to support SFM in the future.
  - c. NB will continue to provide **[\*CONFIDENTIAL\*]** deliveries per week to SFM stores. Delivery frequency is currently, and will be in the future, adjusted up for high volume stores based on purchase volume.
  - d. NB will continue to provide **[\*CONFIDENTIAL\*]** onsite merchandisers at new store openings to help with project management and the direction of onsite vendor supplied merchandising staff, and assist in merchandising the shelf sets.
  - e. NB currently provides a wide range of reports to SFM to support the SFM category management team and business needs, and will continue to work with SFM with reports on as needed basis.

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## Section 3: EX-31.1 (EX-31.1)

**Exhibit 31.1**

### CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, J. Douglas Sanders, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sprouts Farmers Market, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2014

/s/ J. Douglas Sanders

J. Douglas Sanders  
President and Chief Executive Officer  
(Principal Executive Officer)

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## Section 4: EX-31.2 (EX-31.2)

**Exhibit 31.2**

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002**

I, Amin N. Maredia, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sprouts Farmers Market, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2014

/s/ Amin N. Maredia

Amin N. Maredia  
Chief Financial Officer  
(Principal Financial Officer)

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## Section 5: EX-32.1 (EX-32.1)

**Exhibit 32.1**

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Sprouts Farmers Market, Inc., (the "Company") on Form 10-Q for the quarterly period ended September 28, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, J. Douglas Sanders, President and Chief Executive Officer of the Company, certify, based on my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 6, 2014

/s/ J. Douglas Sanders

J. Douglas Sanders  
President and Chief Executive Officer  
(Principal Executive Officer)

This certification accompanies the Report to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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## Section 6: EX-32.2 (EX-32.2)

**Exhibit 32.2**



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Sprouts Farmers Market, Inc., (the "Company") on Form 10-Q for the quarterly period ended September 28, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Amin N. Maredia, Chief Financial Officer of the Company, certify, based on my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 6, 2014

/s/ Amin N. Maredia

Amin N. Maredia  
Chief Financial Officer  
(Principal Financial Officer)

This certification accompanies the Report to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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