

Sprouts Farmers Market, Inc.
Form 10-Q
November 07, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2013

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

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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 Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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 6, 2013, there were outstanding 146,433,944 shares of the registrant's common stock, \$0.001 par value per share.

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FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 29, 2013
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Table of Contents**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 29, 2013	December 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 91,735	\$ 67,211
Accounts receivable, net	8,962	8,415
Inventories	114,765	98,382
Prepaid expenses and other current assets	14,078	4,521
Deferred income tax asset	9,728	24,592
Total current assets	239,268	203,121
Property and equipment, net of accumulated depreciation	348,177	303,166
Intangible assets, net of accumulated amortization	195,790	196,772
Goodwill	368,078	368,078
Other assets	13,118	9,521
Deferred income tax asset	17,372	22,578
Total assets	\$ 1,181,803	\$ 1,103,236
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 117,430	\$ 82,721
Accrued salaries and benefits	20,928	21,397
Other accrued liabilities	26,201	27,561
Current portion of capital and financing lease obligations	2,676	3,379
Current portion of long-term debt	5,684	1,788
Total current liabilities	172,919	136,846
Long-term capital and financing lease obligations	117,632	104,260
Long-term debt	346,094	424,756
Other long-term liabilities	59,524	50,619
Total liabilities	696,169	716,481
Commitments and contingencies		
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, 146,433,944 and 125,956,729 shares issued and outstanding, September 29, 2013 and December 30, 2012, respectively	146	126
Additional paid-in capital	460,271	395,480

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Retained earnings (accumulated deficit)	25,217	(8,851)
Total stockholders' equity	485,634	386,755
Total liabilities and stockholders' equity	\$ 1,181,803	\$ 1,103,236

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

Table of Contents**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 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net sales	\$ 633,614	\$ 510,050	\$ 1,829,675	\$ 1,315,882
Cost of sales, buying and occupancy	443,509	363,641	1,278,623	921,955
Gross profit	190,105	146,409	551,052	393,927
Direct store expenses	129,418	104,450	367,064	268,279
Selling, general and administrative expenses	22,807	25,175	60,259	64,846
Store pre-opening costs	1,237	1,216	5,254	2,070
Store closure and exit costs	(38)	2,273	1,670	3,552
Income from operations	36,681	13,295	116,805	55,180
Interest expense	(8,790)	(9,951)	(30,346)	(25,414)
Other income	203	133	447	201
Loss on extinguishment of debt	(9,507)	(992)	(17,682)	(992)
Income before income taxes	18,587	2,485	69,224	28,975
Income tax provision	(7,126)	(1,178)	(27,178)	(12,816)
Net income	\$ 11,461	\$ 1,307	\$ 42,046	\$ 16,159
Net income per share:				
Basic	\$ 0.08	\$ 0.01	\$ 0.32	\$ 0.14
Diluted	\$ 0.08	\$ 0.01	\$ 0.31	\$ 0.14
Weighted average shares outstanding:				
Basic	139,687	125,794	130,538	116,791
Diluted	144,710	127,820	134,529	118,441

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 STOCKHOLDERS EQUITY
(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	Shares	Common Stock	Additional Paid In Capital	(Accumulated Deficit) / Retained Earnings	Total Stockholders Equity
Balances at January 1, 2012	110,000,008	\$ 110	\$ 295,694	\$ (28,351)	\$ 267,453
Net income				19,500	19,500
Issuance of shares to stockholders	831,314	1	4,999		5,000
Issuance of shares related to Sunflower Transaction	14,898,136	15	89,590		89,605
Issuance of shares	62,271				
Issuance of shares under 2011 Option Plan, net of shares withheld	189,585		549		549
Repurchase of shares	(24,585)		(148)		(148)
Excess income tax benefit in equity			143		143
Equity-based compensation			4,653		4,653
Balances at December 30, 2012	125,956,729	\$ 126	\$ 395,480	\$ (8,851)	\$ 386,755
Net income				42,046	42,046
Issuance of shares under 2011 Option Plan	12,375		75		75
Issuance of shares in IPO, net of issuance costs	20,477,215	20	344,085		344,105
Repurchase of shares	(12,375)		(113)		(113)
Dividend paid to stockholders			(274,051)	(7,978)	(282,029)
Anti-dilution payments made to optionholders			(13,892)		(13,892)
Tax benefit of antidilution payments made to optionholders			4,402		4,402
Equity-based compensation			4,285		4,285
Balances at September 29, 2013	146,433,944	\$ 146	\$ 460,271	\$ 25,217	\$ 485,634

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

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	Thirty-Nine Weeks Ended	
	September 29, 2013	September 30, 2012
Cash flows from operating activities		
Net income	\$ 42,046	\$ 16,159
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	34,860	25,788
Accretion of asset retirement obligation	84	212
Amortization of financing fees and debt issuance costs	2,041	1,876
Loss on disposal of property and equipment	437	2,609
Gain on sale of intangible assets	(19)	
Equity-based compensation	4,285	2,948
Non-cash loss on extinguishment of debt	17,474	992
Deferred income taxes	23,074	10,790
Changes in operating assets and liabilities:		
Accounts receivable	(721)	(2,610)
Inventories	(16,383)	1,290
Prepaid expenses and other current assets	(9,752)	3,590
Other assets	(3,875)	(5,378)
Accounts payable	39,808	6,921
Accrued salaries and benefits	(469)	5,016
Other accrued liabilities	39	3,675
Other long-term liabilities	9,777	8,617
Net cash provided by operating activities	142,706	82,495
Cash flows from investing activities		
Purchases of property and equipment	(74,777)	(28,637)
Proceeds from disposal of property and equipment	2	9,646
Proceeds from sale of intangible assets	172	
Acquisition, net of cash acquired		(130,174)
Net cash used in investing activities	(74,603)	(149,165)
Cash flows from financing activities		
Borrowings on line of credit		3,000
Payments on line of credit		(3,000)
Borrowings on term loan, net of financing costs	688,127	97,247
Payments on term loan	(745,100)	(2,575)
Borrowings on Sr. Subordinated Notes		35,000
Payments on Sr. Subordinated Notes	(35,000)	
Payments on capital lease obligations	(335)	(321)
Payments on financing lease obligations	(2,104)	(1,572)
Payments of deferred financing costs	(1,370)	(401)
Payments of IPO costs	(4,212)	
Cash from landlord related to financing lease obligations	4,057	527

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Payment to stockholders and option holders	(295,921)	
Repurchase of shares	(113)	
Proceeds from the issuance of shares	348,392	5,549
Net cash provided by (used in) financing activities	(43,579)	133,454
Net increase in cash and cash equivalents	24,524	66,784
Cash and cash equivalents at beginning of the period	67,211	14,542
Cash and cash equivalents at the end of the period	\$ 91,735	\$ 81,326
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 31,529	\$ 23,101
Cash paid for income taxes	1,276	1,501
Supplemental disclosure of non-cash investing and financing activities		
Property and equipment in accounts payable	\$ 6,332	\$ 2,832
Property acquired through capital and financing lease obligations	10,986	5,970

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

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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 specialty retailer of natural and organic food, offering a complete shopping experience 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 and its subsidiaries 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 and the consolidated financial statements and notes thereto for the fiscal year ended December 30, 2012 included in the Company's Prospectus dated July 31, 2013, filed on August 2, 2013 pursuant to Rule 424(b)(4) under the Securities Act of 1933, as amended (the Securities Act), in respect of the Company's Registration Statement on Form S-1 (Reg. No. 333-188493).

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 12, Stockholders Equity for more information.

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 2012 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 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 29, 2013, 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.

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

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED) continued

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 are effective for the Company's first quarter of 2014. The Company does not expect adoption of this guidance to have a material effect on its consolidated financial statements.

During the second fiscal quarter of 2013, the Company adopted ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which clarifies how to report the effect of significant reclassifications out of accumulated other comprehensive income. The adoption concerns presentation and disclosure only, and as the Company does not have items of other comprehensive income, it did not have an impact 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 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 Company does not expect the adoption of these provisions to have a material effect on the consolidated financial statements.

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, 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 Level 3 inputs. 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 and Former Term Loan (as defined in Note 7, Long-Term Debt), the fair value of the long-term debt, including current maturities, approximates carrying value as of September 29, 2013 and December 30, 2012. The carrying amount of the Senior Subordinated Promissory Notes (as defined in Note 7, Long-Term Debt) approximates fair value as its terms are consistent with current market rates

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as of December 30, 2012. The Company's estimates of the fair value of long-term debt (including current maturities) and the Senior Subordinated Promissory Notes were classified as Level 2 in the fair value hierarchy.

4. Business Combinations

In May 2012, the Company acquired Sunflower Farmers Markets, Inc., a Delaware corporation (the "Sunflower Transaction"), that operated 37 Sunflower Farmers Market stores ("Sunflower"), which increased the Company's total store count to 143 and extended the Company's footprint into New Mexico, Nevada, Oklahoma and Utah. The Company's consolidated financial statements include the financial position, results of operations and cash flows of Sunflower commencing on May 29, 2012.

Unaudited supplemental pro forma information

The following table presents unaudited supplemental pro forma consolidated results of operations information for the thirteen and thirty-nine weeks ended September 30, 2012. The unaudited supplemental pro forma consolidated results of operations information gives effect to certain adjustments, including depreciation and amortization of the assets acquired and liabilities assumed based on their estimated fair values and changes in interest expense resulting from changes in consolidated debt, as if the Sunflower Transaction occurred at the beginning of 2011:

	Thirteen Weeks Ended September 30, 2012	Thirty-Nine Weeks Ended September 30, 2012
Net sales	\$ 510,050	\$ 1,512,022
Net income	\$ 1,796	\$ 16,969

The unaudited supplemental pro forma consolidated results of operations information is provided for illustrative purposes only and does not purport to present what the actual results of operations would have been had the Sunflower Transaction actually occurred on the date indicated, nor does it purport to represent results of operations for any future period. The unaudited supplemental pro forma information includes certain non-recurring costs incurred as a result of the Sunflower Transaction, such as acquisition-related costs and expenses due to change in control. The information does not reflect any cost savings or other benefits that may be obtained through synergies among the operations of the Company, except to the extent realized in 2012.

5. Accounts Receivable

A summary of accounts receivable is as follows:

	September 29, 2013	As Of December 30, 2012
Vendor	\$ 7,337	\$ 5,602
Landlord incentives	528	845
Medical insurance receivables	26	1,287
Other	1,071	681
Total	\$ 8,962	\$ 8,415

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

As of September 29, 2013 and December 30, 2012, the Company had recorded allowances of \$0.2 million and \$0.3 million, respectively, for certain receivables.

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(UNAUDITED) continued

6. Accrued Salaries and Benefits

A summary of accrued salaries and benefits is as follows:

	September 29, 2013	As Of December 30, 2012
Bonuses	\$ 7,288	\$ 6,253
Vacation	6,749	6,747
Accrued payroll	6,511	5,626
Severance	136	2,528
Other	244	243
Total	\$ 20,928	\$ 21,397

7. Long-Term Debt

A summary of long-term debt is as follows:

Facility	Maturity	Interest Rate	September 29, 2013	As Of December 30, 2012
Senior Secured				
\$700.0 million Term Loan, net of original issue discount	April 2020	Variable	\$ 351,778	\$
\$60.0 million Revolving Credit Facility	April 2018	Variable		
\$410.0 million Former Term Loan, net of original issue discount	April 2018	Variable		391,544
\$50.0 million Former Revolving Credit Facility	April 2016	Variable		
Senior Subordinated Notes				
\$35.0 million Senior Subordinated Promissory Notes	July 2019	10%-14%		35,000
Total debt			351,778	426,544
Less current portion			(5,684)	(1,788)
Long-term debt, net of current portion			\$ 346,094	\$ 424,756

Current portion of long-term debt is presented net of issue discount of \$1.3 million and \$2.3 million as of September 29, 2013 and December 30, 2012, respectively. The noncurrent portion of long-term debt is presented net of issue discount of \$6.9 million and \$11.3 million at September 29, 2013 and December 30, 2012, respectively.

Senior Secured Credit Facilities*April 2013 Refinancing*

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On April 23, 2013, the Company's subsidiary, Sprouts Farmers Markets Holdings, LLC (Intermediate Holdings), as borrower, refinanced (the April 2013 Refinancing) the Former Revolving Credit Facility and the Former Term Loan (each, as defined below), 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 proceeds of the Term Loan were used to repay in full the outstanding Former Term Loan balance of \$403.1 million. Such repayment resulted in an \$8.2 million loss on extinguishment of debt due to the write-off of deferred financing costs and original issue discount. No amounts were outstanding under the Former Revolving Credit Facility. The remaining proceeds from the Term Loan, together with cash on hand, were used to make a \$282.0 million distribution to the Company's equity holders, to make payments of \$13.9 million to vested option holders and to pay transaction fees and expenses related to the refinancing.

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED) continued

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.

Term Loan and Partial Repayment in IPO

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. Such repayment resulted in a \$9.0 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 statement of operations for the thirteen and thirty-nine weeks ended September 29, 2013. As of September 29, 2013, the outstanding balance of the Term Loan was \$351.8 million, net of issue discount of \$8.2 million. Financing fees and issue discount are being amortized to interest expense over the term of the Term Loan.

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

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. There is a prepayment fee equal to 1.00% of the principal amount of the Term Loan under the Credit Facility optionally prepaid in connection with any repricing transaction on or prior to April 23, 2014, the first anniversary of the closing date. Prepayments made thereafter will not be subject to premium or penalty (except LIBOR breakage costs, if applicable).

Revolving Credit Facility

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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

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED) continued

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 29, 2013. Letters of credit totaling \$8.0 million have been issued as of September 29, 2013 primarily to support the Company's insurance programs. Amounts available under the Revolving Credit Facility at September 29, 2013 totaled \$52.0 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;

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 29, 2013.

Former Term Loan and Revolving Credit Facility

On April 18, 2011, the Company, through Intermediate Holdings, entered into senior secured credit facilities (Former Senior Secured Credit Facilities). During April 2012, the Company amended the Former Senior Secured Credit Facilities as described below.

The Former Senior Secured Credit Facilities provided for a \$50.0 million revolving credit facility (Former Revolving Credit Facility), which included a letter of credit subfacility (up to the unused amount of the Former Revolving Credit Facility) and a \$5.0 million swingline loan subfacility.

During April 2011, the Company borrowed \$310.0 million (Former Term Loan), net of financing fees of \$1.3 million and issue discount of \$14.1 million under the Former Term Loan and used the proceeds to effectuate the 2011 combination of Sprouts Farmers Markets, LLC, an Arizona limited liability company (Sprouts Arizona), with Henry s Holdings, LLC, a Delaware limited liability company.

During April 2012, the Company amended the Former Senior Secured Credit Facilities and used the incremental commitments provision to borrow an additional \$100.0 million, net of financing fees of \$0.5 million and issue discount of \$2.7 million, and used the proceeds to effectuate the Sunflower Transaction in May 2012.

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

In connection with the April 2013 Refinancing, the Company repaid the Former Term Loan in its entirety and recorded a related \$8.2 million loss on extinguishment of debt as reflected in the consolidated statement of operations for the thirty-nine weeks ended September 29, 2013.

The Former Term Loan required quarterly principal payments, totaling 1.00% per annum, with the balance payable on the final maturity date.

The Company capitalized total debt issuance costs (financing fees) between 2011 and 2012 of \$1.8 million related to the Former Term Loan, which were being amortized to interest expense over the term of the loan. Additionally, \$16.7 million of lender fees were reflected as a discount on the Former Term Loan and were being charged to interest expense over the term of the Former Term Loan.

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

The Company capitalized debt issuance costs of \$1.8 million related to the Former Revolving Credit Facility, which were being amortized to interest expense over the term of the facility.

There were no amounts outstanding on the Former Revolving Credit Facility at December 30, 2012. Letters of credit totaling \$8.4 million had been issued as of December 30, 2012.

Senior Subordinated Promissory Notes

In May 2012, the Company issued \$35.0 million aggregate principal amount of 10.0% senior subordinated promissory notes (Senior Subordinated Promissory Notes). Interest accrued at 10.0% annually for the first three years, increasing by 1.0% each year thereafter.

On May 31, 2013, the Company repaid the entire balance of \$35.0 million of outstanding Senior Subordinated Promissory Notes and paid \$0.3 million of interest accrued to date.

8. Closed Store Reserves

The following is a summary of closed store reserve activity during the thirty-nine weeks ended September 29, 2013 and fiscal year ended December 30, 2012:

	September 29, 2013	December 30, 2012
Beginning balance	\$ 5,243	\$ 5,427
Additions	363	4,343
Usage	(1,348)	(1,645)
Adjustments	617	(2,882)
Ending balance	\$ 4,875	\$ 5,243

Additions made during 2013 relate to the closure of a former Sunflower warehouse. Adjustments relate to adjustments of sublease estimates. Additions made during 2012 relate to one store closure and the closure of a Sunflower administrative facility. During 2012, an adjustment was made to reflect the release of the Company from a lease for a closed store resulting in a reduction of liability of \$1.3 million. Also, another location previously closed was subleased to an unaffiliated third party, resulting in a reduction of \$2.0 million to the liability. Other adjustments related to changes in sublease income estimates. The closed store reserve balances reflected above primarily consist of future rent payment obligations, net of expected future sublease income, and will be paid over a period of one to eleven years.

9. Income Taxes

The Company's effective tax rate for the thirteen weeks ended September 29, 2013 and September 30, 2012 was 38.3% and 47.4%, respectively. The effective tax rate for the thirty-nine weeks ended September 29, 2013 and September 30, 2012 was 39.3% and 44.2%, respectively. The decrease in the effective tax rate was primarily the result of nondeductible transaction costs for the Sunflower Transaction for the thirteen and thirty-nine weeks ended September 30, 2012. The effective tax rate for the thirteen weeks ended September 29, 2013 included a discrete tax benefit for 2012 income taxes.

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED) continued

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 will not have a significant effect on the Company's consolidated financial statements.

10. Related-Party Transactions

During 2012, the Company incurred costs related to its use of a private aircraft owned by an entity controlled by a member of the Company's board of directors. Fees paid in connection with the use of the aircraft were \$0.2 million and \$0.3 million, during the thirteen and thirty-nine weeks ended September 30, 2012, respectively. During the third quarter of 2012, the Company purchased the aircraft for \$3.2 million.

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 29, 2013 and September 30, 2012, purchases from this company were \$1.7 million and \$1.2 million, respectively. During the thirty-nine weeks ended September 29, 2013 and September 30, 2012, purchases from this company were \$5.6 million and \$3.7 million, respectively. As of September 29, 2013 and December 30, 2012, the accounts receivable amount the Company had recorded from this vendor related to vendor rebates was not material and \$0.4 million, respectively. As of September 29, 2013 and December 30, 2012, the Company had recorded accounts payable due to this vendor of \$0.6 million and \$0.7 million, respectively.

On August 30, 2007, Sprouts Arizona entered into a services agreement (the "Services Agreement") with an outsourced service provider who is a stockholder of the Company, to perform substantially all of the Company's bookkeeping services including among other matters, general ledger maintenance, payroll processing, accounts payable processing, accounts receivable processing, and management reporting. The initial term of the Services Agreement was September 1, 2007 through September 1, 2009 with automatic renewal for successive one-year terms unless either party provides six months' termination notice. During the thirteen weeks ended September 29, 2013 and September 30, 2012, fees and other expenses paid to the service provider under the terms of the Services Agreement were \$0.6 million and \$0.8 million, respectively. During the thirty-nine weeks ended September 29, 2013 and September 30, 2012, fees and other expenses paid to the service provider under the terms of the Services Agreement were \$1.8 million and \$2.2 million, respectively. The Company has an option to terminate the Services Agreement early for a termination fee of \$100,000. If this arrangement were to be terminated, the inability of a third-party service provider to resume these services on a timely basis would impact the Company's business and operating results.

As of December 30, 2012, \$1.0 million of the Senior Subordinated Promissory Notes were held by certain members of senior management of the Company. The Company repaid these amounts as part of full repayment of the Senior Subordinated Promissory Notes on May 31, 2013. See Note 7, "Long-Term Debt" for more information.

11. 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 insurance and self-insurance obligations. Estimation of insurance and self-insurance liabilities requires significant judgment and actual claim settlements and associated expenses may differ from the Company's current provisions for loss.

Table of Contents**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED) continued****12. Stockholders Equity***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. See Note 7, Long-Term Debt for more information.

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 14 Equity-Based Compensation below), the Company paid \$13.9 million to certain vested option holders and reduced the exercise price on 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.

13. 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.

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 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Basic net income per share:				
Net income	\$ 11,461	\$ 1,307	\$ 42,046	\$ 16,159
Weighted average shares outstanding	139,687	125,794	130,538	116,791
Basic net income per share	\$ 0.08	\$ 0.01	\$ 0.32	\$ 0.14
Diluted net income per share:				
Net income	\$ 11,461	\$ 1,307	\$ 42,046	\$ 16,159
Weighted average shares outstanding	139,687	125,794	130,538	116,791
Effect of dilutive options:				
Assumed exercise of options to purchase shares	5,023	2,026	3,991	1,650

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Weighted average shares and equivalent shares outstanding	144,710	127,820	134,529	118,441
Diluted net income per share	\$ 0.08	\$ 0.01	\$ 0.31	\$ 0.14

For both the thirteen and thirty-nine 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. For both the thirteen and thirty-nine weeks ended September 30, 2012 the computation of diluted net income per share does not include 4.5 million options, as those options were unvested performance-based options.

14. 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

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

July 31, 2013 in connection with the Company's IPO and replaced the 2011 Option Plan (except with respect to outstanding options under the 2011 Option Plan). 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 to certain 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 a grant date fair value of \$4.65.

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 Sprouts Farmers Markets, LLC Option Plan (the 2011 Option Plan) to provide employees or directors of the Company with options to acquire shares of the Company (options). 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.

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. In the event of a change in control as defined in the 2011 Option Plan, all options under such plan become immediately vested and exercisable.

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

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Cost of sales, buying and occupancy	\$ 164	\$ 202	\$ 481	\$ 329
Direct store expenses	22	32	81	95
Selling, general and administrative expenses	1,433	1,055	3,723	2,524
Equity-based compensation expense before income taxes	1,619	1,289	4,285	2,948
Income tax benefit	(620)	(611)	(1,684)	(1,303)
Net equity-based compensation expense	\$ 999	\$ 678	\$ 2,601	\$ 1,645

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 12, Stockholders' Equity for more information.

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As of September 29, 2013 and December 30, 2012, there were approximately 5,177,053 and 5,830,000 unvested options outstanding, respectively.

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED) continued

As of September 29, 2013, total unrecognized compensation expense related to outstanding options was \$5.4 million which, if the service and performance conditions are fully met, is expected to be recognized over the next 0.9 years on a weighted-average basis.

During the thirteen weeks ended September 29, 2013, there were no exercises of options. During the thirty-nine weeks ended September 29, 2013, the Company received \$0.1 million in cash proceeds from the exercise of options.

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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 the prospectus dated July 31, 2013 filed pursuant to Rule 424(b)(4) under the Securities Act, with the Securities and Exchange Commission on August 2, 2013 (referred to as the Prospectus). All dollar amounts included below are in thousands, unless otherwise noted.

Business Overview

Sprouts Farmers Market, Inc. is a high-growth, differentiated, specialty retailer of natural and organic food focusing on health and wellness at great value. We offer a complete shopping experience 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 167 stores in eight states as of September 29, 2013, 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 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

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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 19 stores during 2013. 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 12% or more 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, information technology systems, 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. (referred to as the Apollo Funds), and added 43 stores by merging with Henry's and its Sun Harvest-brand stores. Our merger with Henry's Holdings, LLC (referred to as Henry's) 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. We refer to the acquisitions of Henry's and Sunflower as the Henry's Transaction and the Sunflower Transaction, respectively, and collectively as the Transactions. 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).

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 2012 and 2013 were thirteen-week periods ended September 30, 2012 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 pro forma comparable store sales growth to evaluate and identify trends in our sales performance. Pro forma comparable store sales growth reflects comparable store sales growth calculated as if the Sunflower Transaction had occurred on the first day of fiscal 2012. Our practice is to

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include sales from a store in comparable store sales beginning on the first 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. This practice may differ from the methods that other retailers use to calculate similar measures. We use pro forma comparable store sales to calculate pro forma comparable store sales growth. See Unaudited Supplemental Pro Forma Condensed Consolidated Financial Information for a reconciliation of historical net sales to pro forma net sales for the thirty-nine weeks ended September 30, 2012.

Our net sales have increased substantially as a result of the Sunflower Transaction. Net sales are also 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 periodically 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. In the first half of fiscal 2012, we experienced produce price deflation, which contributed to higher gross margins in our business during that period and the full fiscal year.

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

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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.

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Selling, general and administrative expenses

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

We expect our selling, general and administrative expenses will increase in future periods as a result of incremental share-based compensation, legal, accounting and other compliance-related expenses associated with being a public company and increases resulting from growth in the number of our stores.

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 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 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 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 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

Historically, although we were structured as a limited liability company, 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. 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 will not have a significant effect on our consolidated financial statements.

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Factors Affecting Comparability of Results of Operations

Pro Forma Information Sunflower Transaction

In May 2012, we acquired Sunflower in the Sunflower Transaction. Commencing on May 29, 2012, our consolidated financial statements also include the financial position, results of operations and cash flows of Sunflower. The effects of the Sunflower Transaction have a material effect on the comparability of our results of operations for the thirty-nine weeks ended September 29, 2013 compared to the thirty-nine weeks ended September 30, 2012. Consequently, we have supplemented the comparative discussion of our results of operations for the thirty-nine weeks ended September 29, 2013 and September 30, 2012 with a comparative discussion of our historical results of operations on a pro forma basis for the thirty-nine weeks ended September 30, 2012. In this discussion, pro forma statement of operations information for the thirty-nine weeks ended September 30, 2012 gives effect to the Sunflower Transaction as if it was consummated on the first day of fiscal 2012 as set out under *Pro Forma for Sunflower Transaction* in *Unaudited Pro Forma Condensed Consolidated Financial Information*. Pro forma information for the thirteen weeks ended September 30, 2012 is not presented as there is no material effect from the Sunflower Transaction on the comparability of our results for the thirteen week period.

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 7 *Long-Term Debt* and Note 12 *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.

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.

Table of Contents**Results of Operations for Thirteen Weeks Ended September 29, 2013 and September 30, 2012**

The following tables set forth our unaudited results of operations, supplemental pro forma information 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.

Unaudited Quarterly Consolidated Statement of Operations Data:	Thirteen weeks ended	
	September 29, 2013	September 30, 2012
Net sales	\$ 633,614	\$ 510,050
Cost of sales, buying and occupancy	443,509	363,641
Gross profit	190,105	146,409
Direct store expenses	129,418	104,450
Selling, general and administrative expenses	22,807	25,175
Store pre-opening costs	1,237	1,216
Store closure and exit costs	(38)	2,273
Income from operations	36,681	13,295
Interest expense	(8,790)	(9,951)
Other income	203	133
Loss on extinguishment of debt	(9,507)	(992)
Income before income taxes	18,587	2,485
Income tax provision	(7,126)	(1,178)
Net income	\$ 11,461	\$ 1,307

	Thirteen weeks ended	
	September 29, 2013	September 30, 2012
Pro forma comparable store sales growth(1)	10.2%	10.0%
Other Operating Data:		
Stores at beginning of period	160	145
Opened	7	4
Closed		(1)
Stores at end of period	167	148

- (1) See the explanation of pro forma comparable store sales growth above under Components of Operating Results Net Sales. Comparison of Thirteen Weeks Ended September 29, 2013 to Thirteen Weeks Ended

September 30, 2012

Net sales

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	Thirteen weeks ended		Change	% Change
	September 29, 2013	September 30, 2012		
Net sales	\$ 633,614	\$ 510,050	\$ 123,564	24%
Pro forma comparable store sales growth	10.2%	10.0%		

Net sales increased during the thirteen weeks ended September 29, 2013 as compared to the thirteen weeks ended September 30, 2012, primarily as a result of (i) new store openings during 2013 and (ii) sales growth at stores operated prior to the thirteen weeks ended September 30, 2012. This growth was partially offset by a \$1.2 million decrease in net sales related to a store closed in 2012.

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New store openings during fiscal 2013 contributed \$65.6 million, or 53%, of the increase in net sales during the thirteen weeks ended September 29, 2013. Additionally, \$59.1 million, or 48%, of the increase in net sales resulted from comparable store sales growth and new store openings during fiscal 2012 not yet reflected in comparable store sales growth.

Cost of sales, buying and occupancy and gross profit

	Thirteen weeks ended		Change	% Change
	September 29, 2013	September 30, 2012		
Net sales	\$ 633,614	\$ 510,050	\$ 123,564	24%
Cost of sales, buying and occupancy	443,509	363,641	79,868	22%
Gross profit	190,105	146,409	43,696	30%
Gross margin	30.0%	28.7%	1.3%	

Cost of sales, buying and occupancy increased during the thirteen weeks ended September 29, 2013 compared to the thirteen weeks ended September 30, 2012, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. During the thirteen weeks ended September 29, 2013, gross profit increased \$35.5 million as a result of increased sales volume and \$8.2 million as a result of increased margin. The 130 basis point increase in gross margin during the thirteen weeks ended September 29, 2013 reflects higher margins related to various promotions and product markdowns related to merchandise alignment surrounding the Sunflower transition in 2012 and lower occupancy costs as a percentage of net sales due to leverage, partially offset by lower margins in produce due to tighter supply on certain items.

Direct store expenses

	Thirteen weeks ended		Change	% Change
	September 29, 2013	September 30, 2012		
Direct store expenses	\$ 129,418	\$ 104,450	\$ 24,968	24%
Percentage of net sales	20.4%	20.5%	(0.1)%	

Direct store expenses increased during the thirteen weeks ended September 29, 2013 compared to the thirteen weeks ended September 30, 2012, primarily due to \$13.7 million of direct store expenses related to new store openings. The remaining \$11.6 million increase in direct store expenses is associated with stores operated prior to the thirteen weeks ended September 29, 2013. Direct store expenses, as a percentage of net sales, decreased 10 basis points primarily as a result of lower non-capitalizable store development costs and store supplies, partially offset by increased health insurance and higher bonus attainment based on our financial results.

Selling, general and administrative expenses

	Thirteen weeks ended		Change	% Change
	September 29, 2013	September 30, 2012		
Selling, general and administrative expenses	\$ 22,807	\$ 25,175	\$ (2,368)	(9)%
Percentage of net sales	3.6%	4.9%	(1.3)%	

The decrease in selling, general and administrative expenses during the thirteen weeks ended September 29, 2013 includes a \$5.6 million decrease in acquisition and integration costs and a \$2.7

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million settlement related to a trademark dispute recorded in 2012. These decreases were partially offset by \$3.2 million of bonuses paid related to our IPO, \$0.9 million of expenses related to technology initiatives, a \$0.7 million increase in payroll and benefits, a \$0.4 million increase in equity-based compensation expense and a \$0.4 million increase in regional personnel and travel expenses related to increased store count. Selling, general and administrative expenses decreased as a percentage of net sales during the thirteen weeks ended September 29, 2013 due to improved leverage of fixed selling, general and administrative expenses, primarily as a result of comparable store sales growth and the decrease in acquisition and integration costs and prior year settlement expense described above.

Store pre-opening costs

Store pre-opening costs were \$1.2 million for each of the thirteen weeks ended September 29, 2013 and September 30, 2012. Store pre-opening costs in the thirteen weeks ended September 29, 2013 included costs related to opening seven stores during that period. Store pre-opening costs in the thirteen weeks ended September 30, 2012 included costs related to opening four stores during that period. A significant portion of the costs incurred related to the seven stores opened in the thirteen weeks ended September 29, 2013 was incurred in previous quarters due to the timing of the store openings.

Store closure and exit costs

Store closure and exit costs for the thirteen weeks ended September 30, 2012 includes charges related to the closure of a former Sunflower administrative facility and the closure of one store.

Loss on extinguishment of debt

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 issue discount. Additionally, the loss on extinguishment of debt includes \$0.5 million related to the renewal of a financing lease.

We recorded a \$1.0 million loss on extinguishment of debt related to the renewal of a financing lease during the thirty-nine weeks ended September 30, 2012.

Interest expense

Interest expense decreased to \$8.8 million for the thirteen weeks ended September 29, 2013 from \$10.0 million for the thirteen weeks ended September 30, 2012. The decrease is due to lower principal balances on our term loan and the repayment of the Senior Subordinated Notes as well as decreased interest rates related to the April 2013 Refinancing.

Income tax provision

Income tax provision increased to \$7.1 million for the thirteen weeks ended September 29, 2013 from \$1.2 million for the thirteen weeks ended September 30, 2012, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 38.3% in the thirteen weeks ended September 29, 2013 from 47.4% in the thirteen weeks ended September 30, 2012 due to the non-deductible transaction costs incurred in the thirteen weeks ended September 30, 2012 related to the Sunflower Transaction.

Table of Contents*Net income*

	Thirteen weeks ended		Change	% Change
	September 29, 2013	September 30, 2012		
Net income	\$ 11,461	\$ 1,307	\$ 10,154	777%
Percentage of net sales	1.8%	0.3%	1.5%	

Net income increased to \$11.5 million during the thirteen weeks ended September 29, 2013 compared to \$1.3 million during the thirteen weeks ended September 30, 2012. This improvement in net income was primarily due to a \$43.7 million increase in gross profit attributable to the increased sales volumes as a result of new store openings and comparable store sales growth, as described above, a \$2.4 million decrease in selling, general and administrative expenses, a \$2.3 million decrease in store closure and exit costs and a \$1.2 million decrease in interest expense. This increase in net income was partially offset by a \$25.0 million increase in direct store expenses, resulting from the increase in our store base, an \$8.5 million increase in loss on extinguishment of debt primarily related to the August 2013 pay down of debt using proceeds from our IPO and a \$5.9 million increase in income tax provision.

Table of Contents**Results of Operations for Thirty-Nine Weeks Ended September 29, 2013 and September 30, 2012**

The following tables set forth our unaudited results of operations, supplemental pro forma information 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.

	September 29, 2013 (As Reported)	Thirty-Nine weeks ended September 30, 2012 (As Reported)	September 30, 2012 (Pro Forma)
Consolidated Statement of Operations Data and Unaudited Supplemental Pro Forma Information(1):			
Net sales	\$ 1,829,675	\$ 1,315,882	\$ 1,512,022
Cost of sales, buying and occupancy	1,278,623	921,955	1,060,573
Gross profit	551,052	393,927	451,449
Direct store expenses	367,064	268,279	303,726
Selling, general and administrative expenses	60,259	64,846	70,109
Store pre-opening costs	5,254	2,070	4,506
Store closure and exit costs	1,670	3,552	3,611
Income from operations	116,805	55,180	69,497
Interest expense	(30,346)	(25,414)	(30,352)
Other income	447	201	288
Loss on extinguishment of debt	(17,682)	(992)	(992)
Income before income taxes	69,224	28,975	38,441
Income tax provision	(27,178)	(12,816)	(17,382)
Net income	\$ 42,046	\$ 16,159	\$ 21,059

- (1) Unaudited supplemental pro forma information for the thirty-nine weeks ended September 30, 2012 gives effect to the Sunflower Transaction as if it was consummated on the first day of fiscal 2012. See - Unaudited Supplemental Pro Forma Condensed Consolidated Financial Information for pro forma information for the thirty-nine weeks ended September 30, 2012 presented as Pro Forma for Sunflower Transaction.

	September 29, 2013	Thirty-Nine weeks ended September 30, 2012
Pro forma comparable store sales growth(2)	9.7%	10.1%
Other Operating Data:		
Stores at beginning of period	148	103
Opened	19	9
Acquired		37
Closed		(1)
Stores at end of period	167	148

- (2) See the explanation of pro forma comparable store sales growth above under Components of Operating Results Net Sales.

Table of Contents**Comparison of Thirty-Nine Weeks Ended September 29, 2013 to Thirty-Nine Weeks Ended September 30, 2012 and Pro Forma Thirty-Nine Weeks Ended September 30, 2012***Net sales*

	Thirty-Nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (As Reported)		
Net sales	\$ 1,829,675	\$ 1,315,882	\$ 513,793	39%

	Thirty-Nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (Pro Forma)		
Net sales	\$ 1,829,675	\$ 1,512,022	\$ 317,653	21%
Pro forma comparable store sales growth	9.7%	10.1%		

Net sales increased during the thirty-nine weeks ended September 29, 2013 as compared to the thirty-nine weeks ended September 30, 2012, primarily as a result of (i) stores added through the Sunflower Transaction in fiscal 2012, (ii) new store openings and (iii) sales growth at stores operated prior to the thirty-nine weeks ended September 30, 2012.

Stores added through the Sunflower Transaction contributed \$233.4 million, or 45%, of the increase in net sales in the thirty-nine weeks ended September 29, 2013. New store openings during the thirty-nine weeks ended September 29, 2013 contributed \$123.0 million, or 24%, of the increase in net sales during the thirty-nine weeks ended September 29, 2013. The remaining \$159.3 million, or 31%, of the increase in net sales resulted from net sales growth at stores operated prior to September 30, 2012. These increases were partially offset by \$2.0 million of net sales related to a store closed in 2012.

Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, net sales increased primarily as a result of pro forma comparable store sales growth and new store openings. Pro forma comparable store sales growth of 9.7% during the thirty-nine weeks ended September 29, 2013 contributed \$144.0 million, or 45% of the increase in pro forma net sales during the thirty-nine weeks ended September 29, 2013. New store openings during the thirty-nine weeks ended September 29, 2013 contributed \$123.0 million, or 39%, of the increase in net sales during the thirty-nine weeks ended September 29, 2013. The remaining \$50.7 million, or 16%, of the increase in net sales during the thirty-nine weeks ended September 29, 2013 was attributable to new store openings during fiscal 2012 not yet reflected in pro forma comparable store sales growth.

Cost of sales, buying and occupancy and gross profit

	Thirty-Nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (As Reported)		
Net sales	\$ 1,829,675	\$ 1,315,882	\$ 513,793	39%
Cost of sales, buying and occupancy	1,278,623	921,955	356,668	39%
Gross profit	551,052	393,927	157,125	40%
Gross margin	30.1%	29.9%	0.2%	

	Thirty-Nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (Pro Forma)		
Net sales	\$ 1,829,675	\$ 1,512,022	\$ 317,653	21%
Cost of sales, buying and occupancy	1,278,623	1,060,573	218,050	21%
Gross profit	551,052	451,449	99,603	22%
Gross margin	30.1%	29.9%	0.2%	

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Cost of sales, buying and occupancy increased during the thirty-nine weeks ended September 29, 2013 compared to the thirty-nine weeks ended September 30, 2012, primarily due to the increase in sales following the Sunflower Transaction, new store openings and comparable store sales growth, as discussed above. During the thirty-nine weeks ended September 29, 2013, gross profit increased \$153.8 million as a result of increased sales volume and \$3.3 million as a result of an increase in gross margin. The 20 basis point increase in gross margin during the thirty-nine weeks ended September 29, 2013 reflects decreases in occupancy expenses as a percentage of net sales due to operating leverage offset slightly by decreased food margin related to lower margins in produce driven by inflation in certain commodity items and lower margins in the vitamin and supplement and body care departments due to merchandise alignment across Sprouts and former Henry's and Sunflower stores.

Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, cost of sales, buying and occupancy and gross margin increased primarily due to the factors noted above.

Direct store expenses

	Thirty-Nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (As Reported)		
Direct store expenses	\$ 367,064	\$ 268,279	\$ 98,785	37%
Percentage of net sales	20.1%	20.4%	(0.3)%	

	Thirty-Nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (Pro Forma)		
Direct store expenses	\$ 367,064	\$ 303,726	\$ 63,338	21%
Percentage of net sales	20.1%	20.1%	%	

Direct store expenses increased during the thirty-nine weeks ended September 29, 2013 compared to the thirty-nine weeks ended September 30, 2012, primarily due to \$47.1 million of direct store expenses associated with additional stores we operated during the thirty-nine weeks ended September 29, 2013 related to the Sunflower Transaction and new store openings. Direct store expenses, as a percentage of net sales, decreased 30 basis points primarily related to a reduction in non-capitalizable store development costs as a percentage of sales.

Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, direct store expenses increased due to \$25.2 million of direct store expenses associated with new store openings in 2013. The remainder of the increase is related to stores that were opened during or prior to 2012. Direct store expenses, as a percentage of net sales were consistent with those of the thirty-nine weeks ended September 30, 2012.

Table of Contents***Selling, general and administrative expenses***

	Thirty-Nine weeks ended			
	September 29, 2013	September 30, 2012	Change	% Change
		(As Reported)		
Selling, general and administrative expenses	\$ 60,259	\$ 64,846	\$ (4,587)	(7)%
Percentage of net sales	3.3%	4.9%	(1.6)%	

	Thirty-Nine weeks ended			
	September	September	Change	% Change
	29, 2013	30, 2012		
		(Pro Forma)		
Selling, general and administrative expenses	\$ 60,259	\$ 70,109	\$ (9,850)	(14)%
Percentage of net sales	3.3%	4.6%	(1.3)%	

The decrease in selling, general and administrative expenses during the thirty-nine weeks ended September 29, 2013 includes a \$16.3 million decrease in acquisition and integration costs and \$2.7 million related to settlement of a tradename dispute recorded in 2012. These decreases were partially offset by \$3.2 million of bonuses paid in conjunction with our IPO, a \$2.0 million increase in advertising, a \$2.8 million increase in expenses related to technology initiatives, a \$1.9 million increase in regional personnel and travel expenses related to increased store count, \$1.2 million of increased equity-based compensation and payroll taxes including expense related to the anti-dilution payments made in April 2013, \$1.0 million of IPO related expenses and \$1.0 million in payroll and benefits. Selling, general and administrative expenses decreased as a percentage of net sales during the thirty-nine weeks ended September 29, 2013 due to improved leverage of fixed selling, general and administrative expenses, primarily as a result of comparable store sales growth, synergies achieved from the integration of the Sunflower Transaction and the decrease in acquisition and integration costs described above.

Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, selling, general and administrative expenses decreased primarily due a \$13.0 million decrease in acquisition and integration costs, \$2.7 million decrease related to settlement of a tradename dispute recorded in 2012 and a \$2.4 million decrease in administrative payroll and benefits related to synergies achieved from the integration of Sunflower. These items were offset by \$3.2 million of bonuses paid in conjunction with our IPO, a \$2.8 million increase in expenses related to technology initiatives, \$1.2 million of increased equity based compensation and payroll taxes including expense related to the anti-dilution payments made in April 2013 and \$1.0 million of IPO related expenses. Selling, general and administrative expenses decreased as a percentage of net sales during the thirty-nine weeks ended September 29, 2013 due to improved leverage of fixed selling, general and administrative expenses, primarily as a result of comparable store sales growth, synergies achieved from the integration of the Sunflower Transaction and the decrease in acquisition and integration costs described above.

Store pre-opening costs

Store pre-opening costs increased to \$5.3 million for the thirty-nine weeks ended September 29, 2013 from \$2.1 million for the thirty-nine weeks ended September 30, 2012. Store pre-opening costs in the thirty-nine weeks ended September 29, 2013 primarily include pre-opening costs related to the 19 stores opened during that period. Store pre-opening costs for the thirty-nine weeks ended September 30, 2012 include pre-opening costs related to nine stores opened during that time period. Of those nine stores, two were stores acquired in the Sunflower Transaction, where a portion of the related pre-opening costs are reflected in the Sunflower pre-acquisition financial statements (and accordingly, in the pro forma pre-opening costs discussed below). The increase in store pre-opening costs in the thirty-nine weeks ended September 29, 2013 is due to the increased number of stores opened, increases related to opening stores in new markets which require additional pre-opening advertising, travel and team member training expenses, and certain pre-opening costs for stores opened in the thirty-nine weeks ended September 30, 2012 that were incurred in the Sunflower pre-acquisition financial statements. See pro forma pre-opening cost discussion below.

Store pre-opening costs increased to \$5.3 million during the thirty-nine weeks ended September 29, 2013 compared to \$4.5 million during the pro forma thirty-nine weeks ended September 30, 2012.

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Store pre-opening costs for the thirty-nine weeks ended September 29, 2013 are described above. Pro forma store pre-opening costs for the thirty-nine weeks ended September 30, 2012 include store pre-opening costs incurred by both us and Sunflower for the nine stores opened during that period. Seven stores were opened by us and two stores were opened by Sunflower prior to the Sunflower Transaction. Pre-opening costs recorded by Sunflower reflect higher store pre-opening rent incurred by Sunflower prior to the Sunflower Transaction due to early commencement dates for pre-combination leases. The increase in store pre-opening costs in the thirty-nine weeks ended September 29, 2013 is due to an increased number of store openings and increases related to opening stores in new markets as described above, offset by the impact of higher pre-opening costs incurred by Sunflower as described above.

Store closure and exit costs

Store closure and exit costs decreased to \$1.7 million for the thirty-nine weeks ended September 29, 2013 from \$3.6 million for the thirty-nine weeks ended September 30, 2012. The thirty-nine weeks ended September 29, 2013 includes charges related to the closure of a former Sunflower warehouse and adjustments to sublease estimates for stores and facilities already closed. The thirty-nine weeks ended September 30, 2012 includes charges related to the closure of a former Sunflower administrative facility and one store.

Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, store closure and exit costs decreased to \$1.7 million for the thirty-nine weeks ended September 29, 2013 from \$3.6 million for the thirty-nine weeks ended September 30, 2012, primarily due to the factors noted above.

Loss on extinguishment of debt

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.

We recorded a \$1.0 million loss on extinguishment of debt related to the renewal of a financing lease during the thirty-nine weeks ended September 30, 2012.

Interest expense

Interest expense increased to \$30.3 million for the thirty-nine weeks ended September 29, 2013 from \$25.4 million for the thirty-nine weeks ended September 30, 2012, primarily as a result of increased interest expense related to the April 2013 Refinancing and incremental borrowings and financing leases associated with the Sunflower Transaction. These were partially offset by a reduction in the interest rate related to the April 2013 Refinancing, the August 2013 pay down on the Term Loan, and the May 2013 payoff of the Senior Subordinated Notes. See Note 7 Long-Term Debt to our unaudited consolidated financial statements.

Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, interest expense decreased to \$30.3 million for the thirty-nine weeks ended September 29, 2013 from \$30.4 million for the thirty-nine weeks ended September 30, 2012, primarily due to the factors noted above.

Income tax provision

Income tax provision increased to \$27.2 million for the thirty-nine weeks ended September 29, 2013 from \$12.8 million for the thirty-nine weeks ended September 30, 2012, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 39.3% in the thirty-nine weeks ended September 29, 2013 from 44.2% in the thirty-nine weeks ended September 30, 2012 related to the non-deductible transaction costs incurred in the thirty-nine weeks ended September 30, 2012 related to the Sunflower Transaction.

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Comparing the thirty-nine weeks ended September 29, 2013 to the pro forma thirty-nine weeks ended September 30, 2012, income tax provision was \$27.2 million for the thirty-nine weeks ended September 29, 2013 compared to income tax provision of \$17.4 million for the thirty-nine weeks ended September 30, 2012, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 39.3% in the thirty-nine weeks ended September 29, 2013 from 45.2% in the thirty-nine weeks ended September 30, 2012 related to the non-deductible transaction costs incurred in the comparable prior year period related to the Sunflower Transaction.

Net income

	Thirty-nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (As Reported)		
Net income	\$ 42,046	\$ 16,159	\$ 25,887	160%
Percentage of net sales	2.3%	1.2%	1.1%	

	Thirty-nine weeks ended		Change	% Change
	September 29, 2013	September 30, 2012 (Pro Forma)		
Net income	\$ 42,046	\$ 21,059	\$ 20,987	100%
Percentage of net sales	2.3%	1.4%	0.9%	

Net income increased to \$42.0 million during the thirty-nine weeks ended September 29, 2013 compared to \$16.2 million during the thirty-nine weeks ended September 30, 2012. This improvement in net income was primarily due to a \$157.2 million increase in gross profit primarily attributable to the increased sales volumes following the Sunflower Transaction, new store openings and comparable store sales growth, as described above, a \$4.6 million decrease in selling, general and administrative expenses and a \$1.9 million decrease in store closure and exit costs. This increase in net income was partially offset by a \$98.8 million increase in direct store expenses, resulting from the increase in our store base, a \$16.7 million increase in loss on extinguishment of debt primarily related to the April 2013 Refinancing and pay down of debt using proceeds from our IPO, a \$3.2 million increase in store pre-opening costs, a \$4.9 million increase in interest expense and a \$14.4 million increase in income tax provision.

Net income of \$42.0 million during the thirty-nine weeks ended September 29, 2013 also increased compared to pro forma net income of \$21.1 million during the thirty-nine weeks ended September 30, 2012. This improvement in net income was primarily due to a \$99.6 million increase in gross profit attributable to the increased sales volumes resulting from new store openings and comparable store sales growth, as described above, and a \$9.9 million decrease in selling, general and administrative expenses. These factors were partially offset by a \$63.3 million increase in direct store expenses due to new store openings, an \$16.7 million increase in loss on extinguishment of debt related to the April 2013 Refinancing, pay down of debt using proceeds from our IPO and a \$9.8 million increase in income tax provision.

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Unaudited Supplemental Pro Forma Condensed Consolidated Financial Information

The comparability of our results of operations is affected for the periods presented in this Management's Discussion and Analysis of Financial Condition and Results of Operations by the Sunflower Transaction. To supplement the discussion of our historical results of operations for the thirty-nine weeks ended September 30, 2012, we have included unaudited supplemental pro forma condensed consolidated statement of operations information for the thirty-nine weeks ended September 30, 2012.

The following unaudited pro forma condensed consolidated financial information includes our historical results of operations and the results of operations of Sunflower for the thirty-nine weeks ended September 30, 2012, after giving pro forma effect to the Sunflower Transaction and the related financing as described in the accompanying notes (presented as Pro Forma for Sunflower Transaction in the unaudited pro forma condensed consolidated statement of operations).

The historical financial information has been adjusted to give pro forma effect to events that are directly attributable to the Sunflower Transaction, have an ongoing effect on our statement of operations and are factually supportable. Our unaudited pro forma condensed consolidated financial information and explanatory notes present how our financial statements may have appeared had the business actually been combined. The unaudited pro forma condensed consolidated statement of operations shows the impact on the combined statement of operations of the acquisition method of accounting under Financial Accounting Standards Board ASC 805, Business Combinations. Under the acquisition method of accounting, the total purchase price is allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. The excess purchase price over the amounts assigned to tangible and intangible assets acquired and liabilities assumed is recognized as goodwill.

The unaudited pro forma condensed consolidated financial information was prepared in accordance with Article 11 of Regulation S-X, using the assumptions set forth in the notes to the unaudited pro forma condensed consolidated financial information. The following unaudited pro forma condensed consolidated financial information is presented for illustrative purposes only and does not purport to reflect the results the consolidated company may achieve in future periods or the historical results that would have been obtained had the Sunflower Transaction been completed as of January 2, 2012. The unaudited pro forma condensed consolidated financial information also does not give effect to the potential impact of current financial conditions, any anticipated synergies, operating efficiencies or cost savings that may result from the Sunflower Transaction. Furthermore, the unaudited pro forma condensed consolidated statement of operations does not include certain nonrecurring charges and the related tax effects which result directly from the Sunflower Transaction as described in the notes to the unaudited pro forma condensed consolidated financial information.

The unaudited pro forma condensed consolidated financial information is derived from and should be read in conjunction with our historical financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

Table of Contents**SPROUTS FARMERS MARKET, INC.****UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS****For the Thirty-Nine Weeks Ended September 30, 2012****(in thousands, except share and per share amounts)**

	Historical Sprouts Farmers Market, Inc.(1)	Historical Sunflower(1)	Pro Forma Adjustments for		Notes	Pro Forma for Sunflower Transaction(2)
			Sunflower Fiscal Period Alignment(2)	Sunflower Transaction(2)		
Net sales	\$ 1,315,882	\$ 197,612	\$ (1,472)	\$		\$ 1,512,022
Cost of sales, buying and occupancy	921,955	138,880	(1,011)	749	(2)(a)	1,060,573
Gross profit	393,927	58,732	(461)	(749)		451,449
Direct store expenses	268,279	35,956	(287)	(222)	(2)(b)	303,726
Selling, general and administrative expenses	64,846	13,386	(90)	(8,033)	(2)(c)	70,109
Store pre-opening costs	2,070	2,450	(14)			4,506
Store closure and exit costs	3,552	59				3,611
Income from operations	55,180	6,881	(70)	7,506		69,497
Interest expense	(25,414)	(2,019)	14	(2,933)	(2)(d)	(30,352)
Other income	201	88	(1)			288
Loss on extinguishment of debt	(992)					(992)
Income before income taxes	28,975	4,950	(57)	4,573		38,441
Income tax (provision) benefit	(12,816)	(2,796)	14	(1,784)	(2)(e)	(17,382)
Net income	\$ 16,159	\$ 2,154	\$ (43)	\$ 2,789		\$ 21,059
Per Share Information:						
Net income basic	\$ 0.14				(2)(f)	\$ 0.17
Net income diluted	\$ 0.14				(2)(f)	\$ 0.17
Weighted Average Shares:						
Basic	116,791				(2)(f)	125,363
Diluted	118,441				(2)(f)	127,013

The accompanying notes are an integral part of, and should be read in conjunction with, this unaudited pro forma condensed consolidated financial information.

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SPROUTS FARMERS MARKET, INC.

NOTES TO UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL INFORMATION

1. Basis of Presentation and Description of Transaction

Effective May 29, 2012, we acquired all of the outstanding common and preferred stock of Sunflower in the Sunflower Transaction, a transaction accounted for as a business combination, which was financed through the issuance of debt and 14.9 million shares of common stock. For further information about the Sunflower Transaction, see Note 4 to our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

The historical Sprouts Farmers Market, Inc. results of operations for the thirty-nine weeks ended September 30, 2012 are derived from our unaudited consolidated financial statements for the periods then ended also included elsewhere in this Quarterly Report on Form 10-Q. The historical Sunflower results of operations for the period January 1, 2012 to May 28, 2012, were derived from the Sunflower pre-combination unaudited financial statements not included in this Quarterly Report on Form 10-Q. Certain amounts from the Sunflower pre-combination unaudited financial statements have been reclassified to conform to our presentation.

2. Pro Forma for Sunflower Transaction

The historical results of operations have been adjusted to give pro forma effect to events that are (i) directly attributable to the Sunflower Transaction, (ii) factually supportable and (iii) expected to have a continuing impact on the combined results, as if the Sunflower Transaction occurred on the first day of fiscal 2012 (referred to as Pro Forma Adjustments for Sunflower Transaction).

Sunflower's fiscal 2012 commenced one day earlier than our fiscal 2012. Pro forma adjustments for Sunflower Fiscal Period Alignment reflect the pro forma impact of deducting one day from the historical Sunflower results of operations. Additional pro forma adjustments for the Sunflower Transaction consist of the following:

(a) Reflects pro forma adjustments attributable to the application of acquisition accounting to the Sunflower Transaction comprised of (i) a \$0.8 million increase in rent expense, resulting principally from straight-line rent adjustments to rent expense as a result of the new basis in the acquired Sunflower leases as of the acquisition date and (ii) a \$0.1 million decrease in amortization expense related to the fair value of favorable lease intangible assets and unfavorable lease liabilities recognized in the Sunflower Transaction. Management has assumed a weighted average useful life of 11.6 years for amortization of favorable and unfavorable leases in arriving at the pro forma amortization adjustment.

(b) Reflects pro forma adjustments to historical Sunflower depreciation related to the fair values of acquired buildings, leasehold improvements and furniture, fixtures and equipment, which are being amortized and depreciated over their estimated useful lives on a straight-line basis. Measurement of these assets in acquisition accounting is based on acquisition date fair value which was lower than Sunflower pre-acquisition carrying value, primarily due to declines in real estate values and occupancy rates as a result of the recession and deferred maintenance associated with acquired furniture, fixtures and equipment. We also reduced remaining useful lives of certain acquired assets, which accelerated depreciation of those assets. The net effect of the reduction in carrying values and remaining useful lives of the acquired assets resulted in a reduction to pro forma depreciation expense compared to historical depreciation expense. Management has assumed weighted average useful lives of 38.4 years, 7.6 years and 4.7 years for buildings, leasehold improvements and furniture, fixtures and equipment, respectively, in arriving at the pro forma depreciation adjustments.

(c) Reflects costs associated with the Sunflower Transaction, which have been excluded from pro forma results due to the absence of a continuing effect on our business. The costs consist of (i) \$3.2 million of transaction expenses we incurred in 2012 in connection with the Sunflower Transaction, consisting primarily of professional fees, (ii) \$3.5 million of transaction expenses, consisting primarily of professional fees, recorded in Sunflower's historical pre-combination financial statements, and (iii) \$1.1 million of share-based compensation expense associated with a change in control as a result of our acquisition of Sunflower recorded in Sunflower's historical pre-combination financial statements.

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Additionally, the pro forma adjustment includes (i) a \$0.3 million decrease to historical Sunflower depreciation related to the fair value of acquired furniture and fixtures used for general and administrative purposes, which are being depreciated over their estimated useful lives on a straight-line basis and (ii) a \$0.1 million increase to historical amortization expense associated with the Sunflower trade name. Management has assumed weighted average useful lives of 0.4 years for the acquired furniture and fixtures and 10 years for the Sunflower trade name in arriving at the pro forma depreciation and amortization amounts.

^(d) In May 2012, we borrowed an additional \$100.0 million, net of \$0.5 million in financing fees and \$2.7 million of issue discount, under our Former Term Loan and received net proceeds of \$35.0 million from the issuance of the Notes to finance the Sunflower Transaction. The pro forma adjustment represents (i) the incremental interest expense of \$4.0 million from our variable rate Former Term Loan and Notes, including amortization of issue discount and deferred financing fees, based on an interest rate of 6% in effect for the Former Term Loan and 10% for the Notes, (ii) the reversal of historical Sunflower interest expense of \$0.9 million, as the pre-combination Sunflower debt was paid off in connection with the Sunflower Transaction and (iii) a decrease in interest expense of \$0.2 million resulting primarily from the addition of financing leases acquired in the Sunflower Transaction. A one-eighth percentage change in the interest rate would increase or decrease interest expense by \$0.1 million during the thirty-nine weeks ended September 30, 2012.

^(e) The pro forma adjustment to income tax (provision) benefit is derived by applying a blended federal and state statutory tax rate of 39.0% to the pro forma adjustments described above.

^(f) Pro forma net income per weighted average basic and diluted shares outstanding reflects the issuance of 14,898,136 shares to finance the Sunflower Transaction, as if the Sunflower Transaction occurred on the first day of fiscal 2012.

Table of Contents**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 29, 2013	September 30, 2012
Cash and cash equivalents at end of period	\$ 91,735	\$ 81,326
Cash provided by operating activities	\$ 142,706	\$ 82,495
Cash used in investing activities	\$ (74,603)	\$ (149,165)
Cash provided by (used in) financing activities	\$ (43,579)	\$ 133,454

Since inception, we have financed our operations primarily through cash generated from our operations, private placements of our equity, our IPO 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, 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, 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 \$60.2 million to \$142.7 million for the thirty-nine weeks ended September 29, 2013 compared to \$82.5 million for the thirty-nine weeks ended September 30, 2012. The thirty-nine weeks ended September 29, 2013 includes the full impact of the acquired Sunflower stores. In addition to the increase in the number of stores we operate, we leveraged fixed direct store expenses and selling, general and administrative expenses through comparable store sales growth and a decrease in acquisition and integration costs of \$16.3 million for the comparative periods.

Investing Activities

Net cash used in investing activities decreased to \$74.6 million for the thirty-nine weeks ended September 29, 2013 compared to \$149.2 million for the thirty-nine weeks ended September 30, 2012. The decrease in cash used for investing activities is primarily related to the \$130.2 million cash impact of the Sunflower acquisition in the thirty-nine weeks ended September 30, 2012, offset by an increase in capital expenditures for new store openings, store remodels and maintenance capital expenditures related to the increased scale of operations following the Sunflower Transaction and a decrease in proceeds from the disposal of property and equipment of \$9.6 million.

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 \$70 million to \$75 million in fiscal 2013, net of estimated landlord tenant improvement allowances of \$11 million, 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.

Table of Contents**Financing Activities**

Net cash used in financing activities was \$43.6 million for the thirty-nine weeks ended September 29, 2013 as compared to cash provided by financing activities of \$133.5 million for the thirty-nine weeks ended September 30, 2012. The increase in cash used in financing activities of \$177.1 million is related to the \$295.9 million of dividend and anti-dilution payments made to stockholders and option holders, a net increase on payments of debt, net of new debt issued in 2013, of \$221.6 million and \$4.2 million in IPO expenses. These outflows were partially offset by inflows for an increase of \$342.9 million for stock issued, including stock issued in the IPO and stock option exercises and a \$3.5 million increase in cash received from landlords for lease incentives.

Long-Term Debt and Credit Facilities

See Note 7 Long-Term Debt of our unaudited consolidated financial statements for a description of the April 2013 Refinancing, our Credit Facility, our former credit facilities and our Senior Subordinated Promissory Notes (as defined therein).

Contractual Obligations

The following table summarizes our contractual obligations as of September 29, 2013, except for purchase commitments which are as of December 30, 2012, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

	Total	Payments Due by Period			
		Less Than 1 Year	1-3 Years (in thousands)	4-5 Years	More Than 5 Years
Term Loan, including current portion(1)	\$ 360,000	\$ 7,000	\$ 14,000	\$ 14,000	\$ 325,000
Interest payments on long-term debt(2)	89,873	14,384	28,274	26,924	20,291
Capital and financing lease obligations(3)	154,024	13,214	28,046	28,528	84,236
Operating lease obligations(3)	905,037	68,726	162,430	158,515	515,366
Purchase commitments(4)	31,024	18,921	11,829	274	
Totals(5)	\$ 1,539,958	\$ 122,245	\$ 244,579	\$ 228,241	\$ 944,893

- (1) In connection with the April 2013 Refinancing, we refinanced amounts due under our former credit facilities. The Term Loan will mature in April 2020 and will amortize at a rate of 1.0% per annum of the original amount of the Term Loan, in four equal installments, with the balance due on the maturity date. We made a partial repayment of the Term Loan in August 2013 using \$340.0 million in proceeds from shares sold in our IPO. This repayment reduced payments presented in the More Than 5 Years column. See Note 7 Long-Term Debt to our unaudited consolidated financial statements.
- (2) Represents estimated interest payments on our Term Loan based on principal amounts outstanding as of September 29, 2013, repayment terms and contractual interest rates expected to apply through maturity. We estimated LIBOR based on LIBOR in effect at September 29, 2013 to derive the contractual interest rate expected to apply to our Term Loan. After giving effect to the \$340.0 million repayment in August 2013 and a 0.5% reduction in interest rate effective August 2, 2013, we estimate that our annual cash interest will decrease on a pro forma annualized basis by approximately \$17.1 million from approximately \$31.5 million to \$14.4 million based on our debt balance as of September 29, 2013 and assuming LIBOR rates as of September 29, 2013.
- (3) Represents estimated payments for capital and financing and operating lease obligations as of September 29, 2013. 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 \$0.2 million for the period of less than one year, \$0.3 million for years one to three, \$0.2 million for years four to five, and no payments for the period beyond five years.
- (4) Consists primarily of open purchase orders and commitments under noncancelable service contracts as of December 30, 2012.
- (5) As of December 30, 2012, the Company had recorded \$15.3 million of liabilities related to its self-insurance program. Self-insurance liabilities are not included in the table above because the payments are not contractual in nature and the timing of the payments is uncertain.

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The contractual commitment amounts in the table above are associated with agreements that are enforceable and legally binding. Obligations under contracts that we can cancel without a significant penalty are not included in the table above.

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 periodically 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. In the first half of fiscal 2012, we experienced produce price deflation, which contributed to higher gross margins in our business during that period and the full fiscal year.

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 contributes approximately 26% of our net sales for the thirty-nine weeks ended September 29, 2013, 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, valuations, 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.

We believe that following accounting policies involve a greater degree of judgment and complexity. Accordingly, we believe these are the most critical to fully understand and evaluate our financial condition and results of operations.

Equity-Based Compensation

Following the Henry's Transaction, we adopted the Sprouts Farmers Markets, LLC Option Plan (referred to as the 2011 Option Plan) in May 2011. Grants of options to purchase our shares under this plan have been for equity instruments exchanged for employee services. We account for equity-based compensation in accordance with Financial Accounting Standards Board Accounting Standard Codification Topic 718, Compensation - Stock Compensation (referred to as ASC 718). Compensation expense associated with equity incentive grants requires management judgment to calculate the

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estimated fair value of awards, which typically vest over multi-year periods and for which the ultimate amount of compensation is not known on the date of grant. Time vested 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 for each year. In the event of a change in control as defined in the 2011 Option Plan, all options become immediately vested and exercisable.

The Company's board of directors has adopted, and its equity holders have approved, the Sprouts Farmers Market, Inc. 2013 Incentive Plan (referred to as the 2013 Incentive Plan). The 2013 Incentive Plan became effective upon the completion of our IPO on August 6, 2013 and replaced the 2011 Option Plan (except with respect to outstanding options under the 2011 Option Plan). The 2013 Incentive Plan will enable us to formulate and implement a compensation program that will attract, motivate and retain experienced, highly-qualified team members who will contribute to our financial success, and will align the interests of our team members with those of our stockholders through the ability to grant a variety of stock-based and cash-based awards. The 2013 Incentive Plan will serve as the umbrella plan for our stock-based and cash-based incentive compensation programs for our directors, officers and other team members.

Under the provisions of ASC 718, equity-based compensation expense is measured at the grant date, based on the fair value of the award. As required under this guidance, we estimate forfeitures for options granted which are not expected to vest. Changes in these inputs and assumptions can materially affect the measurement of the estimated fair value of our equity-based compensation expense.

At September 29, 2013, options to acquire 12,035,289 shares were outstanding, and a total of 11,878,460 options were vested or expected to vest. Equity-based compensation expense totaled \$4.3 million and \$2.9 million for the thirty-nine weeks ended September 29, 2013 and September 30, 2012, respectively. The weighted average fair value of options granted to purchase shares was \$4.28 for the thirty-nine weeks ended September 29, 2013. The weighted average fair value of options granted to purchase shares was \$1.88 for the thirty-nine weeks ended September 30, 2012.

We have used the Black-Scholes option pricing model to calculate the fair value of our equity-based compensation awards at grant date. The Black-Scholes model requires the use of highly subjective and complex assumptions to determine the fair value of equity-based compensation awards, including the option's expected term and the price volatility of the underlying stock.

In addition to assumptions used in the Black-Scholes option pricing model, we must also estimate a forfeiture rate to calculate the equity-based compensation cost for our awards. Our forfeiture rate is based on an analysis of our actual forfeitures of grants made under the 2011 Option Plan. We routinely evaluate the appropriateness of the forfeiture rate based on actual forfeiture experience, analysis of employee turnover and expectations of future option exercise behavior.

We will continue to use judgment in evaluating the assumptions related to our equity-based compensation on a prospective basis. If any of the assumptions used in the Black-Scholes model change significantly or estimated forfeiture rates change, equity-based compensation for future awards may differ materially compared with the awards granted previously.

We are also required to estimate the fair value of the common stock underlying our equity-based awards when performing the fair value calculations with the Black-Scholes option-pricing model. Due to the prior absence of a market for our common stock, the fair values were determined by our board of directors, with input from management. Additionally, a majority of awards granted were issued in proximity to transactions with third parties in which we issued equity at arm's-length negotiated values. Grants subsequent to our IPO will be based on the trading value of our common stock.

Inventories

Inventories consist of merchandise purchased for resale, which are stated at the lower of cost or market. The cost method is used for warehouse perishable and store perishable department inventories by assigning costs to each of these items based on a first-in, first-out (referred to as FIFO) basis (net of vendor discounts).

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Effective January 3, 2011, we changed our accounting policy for non-perishable inventories from the lower of cost or market using the retail inventory method (referred to as RIM) to the lower of cost or market using weighted average costs. Our valuation of our non-perishable inventory using weighted average costs includes statistical and other estimation methods which we believe provide a reasonable basis to estimate our inventory values at the end of the respective periods.

Physical inventory counts for non-perishable inventories are performed in our stores during each fiscal quarter end by a third-party inventory counting service. As inventory is adjusted at each period end for the physical inventory results, we believe that all inventories are saleable and no allowances or reserves for shrinkage or obsolescence were recorded as of September 29, 2013.

Goodwill and Intangible Assets

Goodwill represents the cost of acquired businesses in excess of the fair value of assets and liabilities acquired. Our indefinite-lived intangible assets consist of trade names related to Sprouts Farmers Market and liquor licenses. We also hold intangible assets with finite useful lives, consisting of favorable and unfavorable leasehold interests and the Sunflower Farmers Market trade name.

Goodwill and indefinite-lived intangible assets are evaluated for impairment on an annual basis during the fourth fiscal quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Our impairment evaluation of goodwill consists of a qualitative assessment to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If this qualitative assessment indicates it is more likely than not the estimated fair value of a reporting unit exceeds its carrying value, no further analysis is required and goodwill is not impaired. Otherwise, we follow a two-step quantitative goodwill impairment test to determine if goodwill is impaired. The first step of the goodwill impairment test compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying value no further analysis or impairment of goodwill is required. If the carrying value of a reporting unit exceeds its fair value, the fair value of the reporting unit would be allocated to the reporting unit's assets and liabilities based on the relative fair value, with goodwill written down to its implied fair value, if necessary.

Our impairment evaluation for our indefinite-lived intangible assets consists of a qualitative assessment similar to that for goodwill. If our qualitative assessment indicates it is more likely than not that the estimated fair value of an indefinite-lived intangible asset exceeds its carrying value, no further analysis is required and the asset is not impaired. Otherwise, we compare the estimated fair value of the asset to its carrying amount with an impairment loss recognized for the amount, if any, by which carrying value exceeds estimated fair value.

We can elect to bypass the qualitative assessments for goodwill and indefinite-lived intangible assets and proceed directly to the quantitative assessments for goodwill or any indefinite-lived intangible assets in any period. We can resume the qualitative assessment approach in future periods.

We have determined we consist of a single reporting unit. We determine the fair value of the reporting unit and indefinite-lived intangible assets using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies. Significant estimates and assumptions are made in connection with the estimated reporting unit fair value, including projected cash flows, the timing of projected cash flows and applicable discount rates. These estimates and assumptions are generally Level 3 inputs because they are not observable. In the event actual results vary from our estimates and assumptions, or if we change our estimates and assumptions, we may be required to record a goodwill impairment charge.

No impairment of goodwill or indefinite-lived intangible assets was recorded during the thirteen or thirty-nine weeks ended September 29, 2013 and September 30, 2012.

Impairment of Long-Lived Assets

We assess our long-lived assets, including property and finite-lived equipment and intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of

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an asset group may not be recoverable. We group and evaluate long-lived assets for impairment at the individual store level, which is the lowest level at which independent identifiable cash flows are available. Factors for impairment include a significant underperformance relative to expected historical or projected future operating results or a significant negative industry or economic trend. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If impairment is indicated, a loss is recognized for any excess of the carrying value over the estimated fair value of the asset group. The fair value is estimated based on discounted future cash flows or comparable market values, if available.

When assessing the recoverability of our long-lived assets, we make assumptions regarding estimated future cash flows from the use and eventual disposition of the asset groups. We base our estimates on historical experience and projections, and consider recent economic and competitive trends. In the event that our estimates or assumptions change in the future, we may be required to record a long-lived asset impairment charge. We did not record any impairment loss during the thirteen or thirty-nine weeks ended September 29, 2013 and September 30, 2012.

Income Taxes

Until the closing date of the Henry's Transaction, Henry's was not a separate tax-paying entity. Henry's was included in its parent's consolidated federal and certain state income tax groups for income tax reporting purposes. For the period through such closing date, the consolidated financial statements have been prepared on the basis as if Henry's prepared its tax returns and accounted for income taxes on a separate-company basis. As a result of the Henry's Transaction, for tax purposes, Henry's was acquired in a taxable asset acquisition. The purchase price was allocated to Henry's identifiable assets and liabilities with the residual assigned to tax deductible goodwill. The resulting basis differences between the new tax values and historical book amounts resulted in a deferred tax asset of \$47.6 million being recorded through stockholders equity.

In May 2012, we completed the acquisition of a 100% ownership interest in Sunflower. The acquisition was structured to be a tax-free reorganization. The tax basis of the property acquired in reorganization is equal to the basis in the property recorded by Sunflower just prior to the acquisition. The resulting basis difference between the historical tax amounts and the values resulted in net deferred tax assets of \$1.9 million being recorded through goodwill.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. We record interest and penalties related to unrecognized tax benefits as part of income tax expense.

During the ordinary course of business, there are many transactions and calculations for which the ultimate tax settlement is uncertain. Under applicable accounting guidance, we are required to evaluate the realizability of our deferred tax assets. The realization of our deferred tax assets is dependent on future earnings. Applicable accounting guidance requires that a valuation allowance be recognized when, based on available evidence, it is more likely than not that all or a portion of deferred tax assets will not be realized due to the inability to generate sufficient taxable income in future periods. In circumstances where there is significant negative evidence, establishment of a valuation allowance must be considered. A pattern of sustained profitability is considered significant positive evidence when evaluating a decision to reverse a valuation allowance. Further, in those cases where a pattern of sustained profitability exists, projected future taxable income may also represent positive evidence, to the extent that such projections are determined to be reliable given the current economic environment. Accordingly, our assessment of our valuation allowances requires considerable judgment and could have a significant negative or positive impact on our current and future earnings.

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Self-Insurance Reserves

We use a combination of insurance and self-insurance programs to provide reserves for potential liabilities associated with general liability, workers' compensation and employee health benefits. Liabilities for self-insurance reserves are estimated through consideration of various factors, which include historical claims experience, demographic factors, security factors and other actuarial assumptions. We believe our assumptions are reasonable, but the estimated reserves for these liabilities could be affected materially by future events or claims experiences that differ from historical trends and assumptions.

Closed Store Reserve

We recognize a reserve for future operating lease payments 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 noncancelable lease payments 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 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 from original estimates. Adjustments are made for changes in estimate in the period in which the change becomes known, considering timing of new information regarding market, subleases or other lease updates. Adjustments in the closed store reserves are recorded in store closure and exit costs in the consolidated statements of operations.

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 above under "Liquidity and Capital Resources - Long-Term Debt and Credit Facilities," 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 \$360.0 million principal outstanding under our Term Loan as of September 29, 2013, 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 \$3.6 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 Securities Exchange Act of 1934, as amended (referred to as 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 29, 2013, 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 29, 2013, we continued to have a material weakness related to our internal controls with respect to costing of inventories, which we are currently addressing.

Changes in Internal Control Over Financial Reporting

During the quarterly period ended September 29, 2013, 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.

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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 II Item 1A. Risk Factors in our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Use of Proceeds

There has been no material change in the use of proceeds from our IPO as described in our final prospectus dated July 31, 2013 filed with the Securities and Exchange Commission on August 2, 2013 pursuant to Rule 424(b)(4) of the Securities Act and our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2013, as filed with the Securities and Exchange Commission on August 23, 2013.

Item 5. Other Information.

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act

Apollo Global Management, LLC (Apollo) has provided notice to us that, as of October 24, 2013, certain investment funds managed by affiliates of Apollo beneficially owned approximately 22% of the limited liability company interests of CEVA Holdings, LLC (CEVA). Under the limited liability company agreement governing CEVA, certain investment funds managed by affiliates of Apollo hold a majority of the voting power of CEVA and have the right to elect a majority of the board of CEVA. CEVA may be deemed to be under common control with us, but this statement is not meant to be an admission that common control exists. As a result, it appears that we are required to provide disclosures as set forth below pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) and Section 13(r) of the Exchange Act.

Apollo has informed us that CEVA has provided it with the information below relevant to Section 13(r) of the Exchange Act. The disclosure below does not relate to any activities conducted by us and does not involve us or our management. The disclosure relates solely to activities conducted by CEVA and its consolidated subsidiaries. We have not independently verified or participated in the preparation of the disclosure below.

Through an internal review of its global operations, CEVA has identified the following transactions in an Initial Notice of Voluntary Self-Disclosure that CEVA filed with the U.S. Treasury Department Office of Foreign Assets Control (OFAC) on October 28, 2013. CEVA s review is ongoing. CEVA will file a further report with OFAC after completing its review.

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The internal review indicates that, in December 2012, CEVA Freight Italy Srl (CEVA Italy) provided customs brokerage and freight forwarding services for the export to Iran of two measurement instruments to the Iranian Offshore Engineering Construction Company, a joint venture between two entities that are identified on OFAC's list of Specially Designated Nationals (SDN). The revenues and net profits for these services were approximately \$1,260.64 USD and \$151.30 USD, respectively. In February 2013, CEVA Freight Holdings (Malaysia) SDN BHD (CEVA Malaysia) provided customs brokerage for export and local haulage services for a shipment of polyethylene resin to Iran shipped on a vessel owned and/or operated by HDS Lines, also an SDN. The revenues and net profits for these services were approximately \$779.54 USD and \$311.13 USD, respectively. In September 2013, CEVA Malaysia provided customs brokerage services for the import into Malaysia of fruit juice from Alifard Co. in Iran via HDS Lines. The revenues and net profits for these services were approximately \$227.41 USD and \$89.29 USD, respectively.

These transactions violate the terms of internal CEVA compliance policies, which prohibit transactions involving Iran. Upon discovering these transactions, CEVA promptly launched an internal investigation, and is taking action to block and prevent such transactions in the future. CEVA intends to cooperate with OFAC in its review of this matter.

Item 6. Exhibits.

Exhibit Number	Description
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

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SPROUTS FARMERS MARKET, INC.

Date: November 7, 2013

By: */s/ Amin N. Maredia*
Name: Amin N. Maredia
Title: Chief Financial Officer
(Principal Financial Officer)

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