

**SFM 10-Q 7/3/2016**

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

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended July 3, 2016

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.)

**5455 East High Street, Suite 111**

**Phoenix, Arizona 85054**

(Address of principal executive offices and zip code)

**(480) 814-8016**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  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 August 3, 2016, there were outstanding 148,425,408 shares of the registrant's common stock, \$0.001 par value per share.

**SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED JULY 3, 2016**

**TABLE OF CONTENTS**

	<u>Page</u>
<b><u>PART I - FINANCIAL INFORMATION</u></b>	
<u>Item 1. Financial Statements.</u>	1
<u>Consolidated Balance Sheets as of July 3, 2016 and January 3, 2016 (unaudited)</u>	1
<u>Consolidated Statements of Operations for the thirteen and twenty-six weeks ended July 3, 2016 and June 28, 2015 (unaudited)</u>	2
<u>Consolidated Statements of Stockholders' Equity for the twenty-six weeks ended July 3, 2016 and the year ended January 3, 2016 (unaudited)</u>	3
<u>Consolidated Statements of Cash Flows for the twenty-six weeks ended July 3, 2016 and June 28, 2015 (unaudited)</u>	4
<u>Notes to Unaudited Consolidated Financial Statements</u>	5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u>	27
<u>Item 4. Controls and Procedures.</u>	27
<b><u>PART II - OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings.</u>	29
<u>Item 1A. Risk Factors.</u>	29
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.</u>	29
<u>Item 6. Exhibits.</u>	30
<u>Signatures</u>	31

## Forward-Looking Statements

*This Quarterly Report on Form 10-Q contains “forward-looking statements” that involve substantial risks and uncertainties. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the “Exchange Act”), including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses, and plans and objectives of management. In some cases, you can identify forward-looking statements by terms such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “project,” “will,” “would,” “should,” “could,” “can,” “predict,” “potential,” “continue,” “objective,” or the negative of these terms, and similar expressions intended to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and involve known risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievement to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled “Risk Factors” included in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K for the fiscal year ended January 3, 2016, and our other filings with the Securities and Exchange Commission. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

*As used in this Quarterly Report on Form 10-Q, unless the context otherwise requires, references to the “Company,” “Sprouts,” “Sprouts Farmers Market,” “we,” “us” and “our” refer to Sprouts Farmers Market, Inc. and, where appropriate, its subsidiaries.*

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)

	July 3, 2016	January 3, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 78,444	\$ 136,069
Accounts receivable, net	17,719	20,424
Inventories	189,165	165,434
Prepaid expenses and other current assets	19,954	23,288
Total current assets	305,282	345,215
Property and equipment, net of accumulated depreciation	549,726	494,067
Intangible assets, net of accumulated amortization	198,309	198,601
Goodwill	368,078	368,078
Other assets	23,734	19,003
Deferred income tax asset	—	1,400
Total assets	<u>\$ 1,445,129</u>	<u>\$ 1,426,364</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 175,235	\$ 134,480
Accrued salaries and benefits	28,679	30,717
Other accrued liabilities	43,189	50,253
Current portion of capital and financing lease obligations	6,286	14,972
Total current liabilities	253,389	230,422
Long-term capital and financing lease obligations	115,881	115,500
Long-term debt	160,000	160,000
Other long-term liabilities	109,461	97,450
Deferred income tax liability	12,190	—
Total liabilities	<u>650,921</u>	<u>603,372</u>
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Undesignated preferred stock; \$0.001 par value; 10,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 200,000,000 shares authorized, 148,424,200 and 152,577,884 shares issued and outstanding, July 3, 2016 and January 3, 2016, respectively	148	153
Additional paid-in capital	589,458	577,393
Retained earnings	204,602	245,446
Total stockholders' equity	<u>794,208</u>	<u>822,992</u>
Total liabilities and stockholders' equity	<u>\$ 1,445,129</u>	<u>\$ 1,426,364</u>

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

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
Net sales	\$ 1,031,643	\$ 902,153	\$ 2,024,884	\$ 1,759,659
Cost of sales, buying and occupancy	725,841	638,514	1,412,569	1,238,227
Gross profit	305,802	263,639	612,315	521,432
Direct store expenses	207,107	177,381	400,885	340,571
Selling, general and administrative expenses	30,922	23,390	61,818	47,417
Store pre-opening costs	4,213	2,507	8,179	5,280
Store closure and exit costs	98	315	135	1,544
Income from operations	63,462	60,046	141,298	126,620
Interest expense	(3,661)	(4,437)	(7,262)	(10,305)
Other income	90	112	191	174
Loss on extinguishment of debt	—	(5,481)	—	(5,481)
Income before income taxes	59,891	50,240	134,227	111,008
Income tax provision	(22,682)	(18,918)	(50,811)	(42,219)
Net income	<u>\$ 37,209</u>	<u>\$ 31,322</u>	<u>\$ 83,416</u>	<u>\$ 68,789</u>
Net income per share:				
Basic	\$ 0.25	\$ 0.20	\$ 0.56	\$ 0.45
Diluted	\$ 0.25	\$ 0.20	\$ 0.55	\$ 0.44
Weighted average shares outstanding:				
Basic	<u>149,170</u>	<u>153,393</u>	<u>149,931</u>	<u>152,814</u>
Diluted	<u>151,498</u>	<u>155,949</u>	<u>152,322</u>	<u>155,728</u>

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

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

	<u>Shares</u>	<u>Common Stock</u>	<u>Additional Paid In Capital</u>	<u>Retained Earnings</u>	<u>Total Stockholders' Equity</u>
<b>Balances at December 28, 2014</b>	151,833,334	\$ 152	\$ 543,048	\$ 142,189	\$ 685,389
Net income	—	—	—	128,991	128,991
Issuance of shares under option plans	1,812,829	2	6,318	—	6,320
Repurchase and retirement of common stock	(1,068,279)	(1)	-	(25,734)	(25,735)
Excess tax benefit for exercise of options	—	—	20,009	—	20,009
Equity-based compensation	—	—	8,018	—	8,018
<b>Balances at January 3, 2016</b>	152,577,884	\$ 153	\$ 577,393	\$ 245,446	\$ 822,992
Net income	—	—	—	83,416	83,416
Issuance of shares under option plans	541,186	—	2,053	—	2,053
Repurchase and retirement of common stock	(4,979,692)	(5)	-	(124,260)	(124,265)
Excess tax benefit for exercise of options	—	—	3,687	—	3,687
Equity-based compensation	—	—	6,325	—	6,325
<b>Balances at July 3, 2016</b>	<u>148,139,378</u>	<u>\$ 148</u>	<u>\$ 589,458</u>	<u>\$ 204,602</u>	<u>\$ 794,208</u>

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

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

	Twenty-Six Weeks Ended	
	July 3, 2016	June 28, 2015
<b>Cash flows from operating activities</b>		
Net income	\$ 83,416	\$ 68,789
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	38,813	32,816
Accretion of asset retirement obligation and closed facility reserve	176	178
Amortization of financing fees and debt issuance costs	231	501
Loss on disposal of property and equipment	57	405
Equity-based compensation	6,325	2,434
Loss on extinguishment of debt	—	5,481
Deferred income taxes	13,590	1,620
Changes in operating assets and liabilities:		
Accounts receivable	3,015	(4,874)
Inventories	(23,731)	(15,386)
Prepaid expenses and other current assets	3,334	2,220
Other assets	(4,961)	(6,149)
Accounts payable	24,768	26,527
Accrued salaries and benefits	(2,038)	(7,694)
Other accrued liabilities	(7,395)	(2,079)
Other long-term liabilities	12,340	16,151
Cash flows from operating activities	<u>147,940</u>	<u>120,940</u>
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(85,081)	(74,541)
Proceeds from sale of property and equipment	662	2
Purchase of leasehold interests	(491)	—
Cash flows used in investing activities	<u>(84,910)</u>	<u>(74,539)</u>
<b>Cash flows from financing activities</b>		
Proceeds from revolving credit facility	—	260,000
Payments on revolving credit facility	—	(100,000)
Payments on term loan	—	(261,250)
Payments on capital lease obligations	(350)	(316)
Payments on financing lease obligations	(1,780)	(1,700)
Payments of deferred financing costs	—	(1,896)
Repurchase of common stock	(124,265)	—
Excess tax benefit for exercise of stock options	3,687	19,288
Proceeds from the exercise of stock options	2,053	6,218
Cash flows used in financing activities	<u>(120,655)</u>	<u>(79,656)</u>
Decrease in cash and cash equivalents	<u>(57,625)</u>	<u>(33,255)</u>
Cash and cash equivalents at beginning of the period	<u>136,069</u>	<u>130,513</u>
Cash and cash equivalents at the end of the period	<u>\$ 78,444</u>	<u>\$ 97,258</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 7,297	\$ 10,575
Cash paid for income taxes	28,575	19,058
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Property and equipment in accounts payable	\$ 32,183	\$ 12,662
Property acquired through capital and financing lease obligations	4,655	5,373

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

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

**1. Basis of Presentation**

Sprouts Farmers Market, Inc., a Delaware corporation, through its subsidiaries, operates as a healthy grocery store that offers fresh, natural and organic food through a complete shopping experience that includes fresh produce, bulk foods, vitamins and supplements, grocery, meat and seafood, bakery, deli, dairy, frozen foods, natural body care and 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 unless the context otherwise requires, its subsidiaries.

The accompanying unaudited consolidated financial statements include the accounts of the Company in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial statements and are in the form prescribed by the Securities and Exchange Commission in instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial position, results of operations and cash flows for the periods indicated. All material intercompany accounts and transactions have been eliminated in consolidation. Interim results are not necessarily indicative of results for any other interim period or for a full fiscal year. The information included in these consolidated financial statements and notes thereto should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included herein and Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto for the fiscal year ended January 3, 2016 ("fiscal year 2015") included in the Company's Annual Report on Form 10-K, filed on February 25, 2016.

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. The fiscal year ending January 1, 2017 ("fiscal year 2016") is a 52-week year, and fiscal year 2015 was a 53-week year. 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 25% of the Company's net sales for the twenty-six weeks ended July 3, 2016, is generally more available in the first six months of the fiscal year due to the timing of peak growing seasons.

All dollar amounts are in thousands, unless otherwise noted.

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

## **2. Recently Issued Accounting Pronouncements**

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." ASU No. 2014-09 provides guidance for revenue recognition. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, and estimating the amount of variable consideration to include in the transaction price attributable to each separate performance obligation. This guidance will be effective for the Company for its fiscal year 2018, with early adoption permitted. The Company is currently evaluating the potential impact of this guidance.

In April 2015, the FASB issued ASU No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs." ASU No. 2015-03 requires an entity to present debt issuance costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. This guidance is effective for the Company for its fiscal year 2016. The new guidance has been applied retrospectively to each prior period presented, and the adoption did not have a material effect on the Company's consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." ASU No. 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the arrangement does not include a software license, the customer should account for a cloud computing arrangement as a service contract. This guidance is effective for the Company for its fiscal year 2016. The Company adopted this amendment prospectively and the adoption did not have a material effect on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, "Simplifying the Measurement of Inventory." ASU No. 2015-11 changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business; less reasonably predictable costs of completion, disposal and transportation. This guidance will be effective for the Company for its fiscal year 2017. The Company is currently evaluating the potential impact of this guidance.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (ASC 842)." ASU No. 2016-02 requires lessees to recognize a right-of-use asset and corresponding lease liability for all leases with terms greater than twelve months. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. The new guidance also requires certain additional quantitative and qualitative disclosures. This guidance will be effective for the Company for its fiscal year 2019, with early adoption permitted. The Company is currently evaluating the potential impact of this guidance.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities-Extinguishments of Liabilities (Subtopic 405-20): Recognition of breakage for certain prepaid stored-value products." ASU No. 2016-04 provides a narrow scope exception to the guidance in Subtopic 405-20 to require that stored-value breakage be accounted for consistently with the breakage guidance in Topic 606. The amendments in this update contain specific guidance for derecognition of prepaid stored-value product liabilities, thereby eliminating the current and potential future diversity. This guidance will be effective for the Company for its fiscal year 2019, with early adoption permitted. The Company is currently evaluating the potential impact of this guidance.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation – Stock Compensation (Topic 718)." This update involves several aspects of the accounting for share-based transactions, including the income tax consequences, classification of awards as either equity or liabilities, how to account for forfeitures, and classification on the statement of cash flows. The amendments in this update are effective

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

for the Company for its fiscal year 2017, with early adoption permitted. The Company is currently evaluating the potential impact of this guidance.

No other new accounting pronouncements issued or effective during the twenty-six weeks ended July 3, 2016 had, or are expected to have, a material impact on the Company's 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, indefinite-lived intangible assets and long-lived assets and in the valuation of store closure and exit costs.

The determination of fair values of certain tangible and intangible assets for purposes of the Company's goodwill impairment evaluation as described above was based upon a step zero assessment. Closed facility 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 facility 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 Credit Facility (as defined in Note 6, "Long-Term Debt"), the fair value of the long-term debt approximates carrying value as of July 3, 2016 and January 3, 2016. The Company's estimates of the fair value of long-term debt were classified as Level 2 in the fair value hierarchy.

**4. Accounts Receivable**

A summary of accounts receivable is as follows:

	As of	
	July 3, 2016	January 3, 2016
Vendor	\$ 10,613	\$ 11,649
Receivables from landlords	1,452	4,143
Other	5,654	4,632
Total	<u>\$ 17,719</u>	<u>\$ 20,424</u>

The Company had recorded allowances for certain vendor receivables of \$0.1 million and \$0.1 million at July 3, 2016 and January 3, 2016, respectively.

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

**5. Accrued Salaries and Benefits**

A summary of accrued salaries and benefits is as follows:

	As of	
	July 3, 2016	January 3, 2016
Accrued payroll	\$ 12,057	\$ 10,988
Vacation	10,922	8,916
Bonus	4,955	9,728
Other	745	1,085
<b>Total</b>	<b>\$ 28,679</b>	<b>\$ 30,717</b>

**6. Long-Term Debt**

A summary of long-term debt is as follows:

Facility	Maturity	Interest Rate	As of	
			July 3, 2016	January 3, 2016
<b>Senior secured debt</b>				
\$450.0 million Credit Facility	April 17, 2020	Variable	\$ 160,000	\$ 160,000
<b>Total debt</b>			<b>160,000</b>	<b>160,000</b>
<b>Long-term debt</b>			<b>\$ 160,000</b>	<b>\$ 160,000</b>

**Senior Secured Revolving Credit Facility**

*April 2015 Refinancing*

On April 17, 2015, the Company's subsidiary, Sprouts Farmers Markets Holdings, LLC ("Intermediate Holdings"), as borrower, entered into a credit agreement (the "Credit Agreement") to replace the Company's former credit facility and term loan. The Credit Agreement provides for a revolving credit facility with an initial aggregate commitment of \$450.0 million (the "Credit Facility"), which may be increased from time to time pursuant to an expansion feature set forth in the Credit Agreement.

Concurrently with the closing of the Credit Agreement, the Company borrowed \$260.0 million to pay off its \$257.8 million former term loan (the "April 2015 Refinancing"), and to terminate all commitments under its existing senior secured revolving credit facility, dated April 23, 2013, and to pay transaction costs related to the April 2015 Refinancing. Such repayment resulted in a \$5.5 million loss on extinguishment of debt due to the write-off of deferred financing costs and original issue discount. The remaining proceeds of loans made under the Credit Facility were used for general corporate purposes.

The Company capitalized debt issuance costs of \$2.3 million related to the Credit Facility, which are being amortized on a straight-line basis to interest expense over the five-year term of the Credit Facility.

The Credit Agreement also provides for a letter of credit subfacility and a \$15.0 million swingline facility. Letters of credit issued under the Credit Agreement reduce the borrowing capacity of the Credit Facility. Letters of credit totaling \$1.7 million have been issued as of July 3, 2016, primarily to support the Company's insurance programs.

*Guarantees*

Obligations under the Credit Facility are guaranteed by the Company and all of its current and future wholly-owned material domestic subsidiaries, and are secured by first-priority security interests in substantially all of the assets of the Company and its subsidiary guarantors, including, without limitation, a pledge by the Company of its equity interest in Intermediate Holdings.

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

*Interest and Fees*

Loans under the Credit Facility bear interest, at the Company's option, either at adjusted LIBOR plus 1.25% per annum, or a base rate plus 0.25% per annum. The interest rate margins are subject to adjustment pursuant to a pricing grid based on the Company's total gross leverage ratio, as defined in the Credit Agreement. Under the terms of the Credit Agreement, the Company is obligated to pay a commitment fee on the available unused amount of the Credit Facility commitments equal to 0.15% per annum.

Outstanding letters of credit under the Credit Facility are subject to a participation fee of 1.25% per annum and an issuance fee of 0.125% per annum.

*Payments and Prepayments*

The Credit Facility is scheduled to mature, and the commitments thereunder will terminate on April 17, 2020, subject to extensions as set forth in the Credit Agreement.

The Company may repay loans and reduce commitments under the Credit Agreement at any time in agreed-upon minimum principal amounts, without premium or penalty (except LIBOR breakage costs, if applicable).

Following the closing of the Credit Facility and the initial borrowing of \$260.0 million during 2015, the Company made a total of \$100.0 million of principal payments on the Credit Facility, which reduced the Company's total outstanding debt to \$160.0 million at July 3, 2016.

*Covenants*

The Credit Agreement 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 debt or other material agreements; and
- change its fiscal year.

Each of these covenants is subject to customary and other agreed-upon exceptions.

In addition, the Credit Agreement requires that the Company and its subsidiaries maintain a maximum total net leverage ratio not to exceed 3.00 to 1.00 and minimum interest coverage ratio not to be less than 1.75 to 1.00. Each of these covenants is tested on the last day of each fiscal quarter.

The Company was in compliance with all applicable covenants under the Credit Agreement as of July 3, 2016.

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

**7. Closed Facility Reserves**

The following is a summary of closed facility reserve activity during the twenty-six weeks ended July 3, 2016 and fiscal year ended January 3, 2016:

	July 3, 2016	January 3, 2016
Beginning balance	\$ 2,017	\$ 1,785
Additions	—	1,144
Usage	(657)	(1,332)
Adjustments	20	420
Ending balance	<u>\$ 1,380</u>	<u>\$ 2,017</u>

Usage during 2016 relates to lease payments made during the period for closed stores. Additions made during 2015 include remaining lease payments for the corporate support office relocation, and usage during 2015 primarily related to lease payments made during the year for closed stores.

**8. Income Taxes**

The Company's effective tax rate for the thirteen weeks ended July 3, 2016 and June 28, 2015 was 37.9% and 37.7%, respectively. The increase in the effective tax rate is mainly related to an increase in the effective state income tax rate, partially offset by an increase in the enhanced deduction for charitable donations of food inventory.

The Company's effective tax rate for the twenty-six weeks ended July 3, 2016 and June 28, 2015 was 37.9% and 38.0%, respectively. The decrease in the effective tax rate is mainly related to an increase in the enhanced deduction for charitable donations of food inventory and an increase in tax credits, partially offset by an increase in the effective state income tax rate.

Excess tax benefits associated with stock option exercises and vested restricted stock units are credited to stockholders' equity. The Company uses the tax law ordering approach of intraperiod allocation to allocate the benefit of windfall tax benefits based on provisions in the tax law that identify the sequence in which those amounts are utilized for tax purposes. The income tax benefits resulting from stock awards that were credited to stockholders' equity were \$3.7 million for the twenty-six weeks ended July 3, 2016. The excess tax benefits are not credited to stockholders' equity until the deduction reduces income taxes payable.

**9. Related-Party Transactions**

A member of the Company's board of directors is an investor in a company that is a supplier of coffee to the Company. During the thirteen weeks ended July 3, 2016 and June 28, 2015, purchases from this supplier were \$2.7 million and \$2.5 million, respectively. During the twenty-six weeks ended July 3, 2016 and June 28, 2015, purchases from this company were \$5.2 million and \$4.8 million, respectively. At July 3, 2016 and June 28, 2015, the Company had recorded accounts payable due to this supplier of \$0.9 million and \$0.7 million, respectively.

The Company's Executive Chairman of the Board has a financial interest in three separate technology suppliers to the Company. A summary of his relationships and the Company's purchases and outstanding accounts payable balances with these vendors is as follows:

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

	Nature of Relationship	Purchases during				Accounts Payable Outstanding as of	
		Thirteen Weeks Ended		Twenty-Six Weeks Ended		July 3,	June 28,
		July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015	2016	2015
Vendor A	Equity investor and lender	\$ 2,141	\$ 1,807	\$ 3,362	\$ 3,083	\$ 610	\$ 206
Vendor B	Lender	98	87	165	227	9	8
Vendor C	Equity investor	243	—	260	—	40	—
<b>Total</b>		<u>\$ 2,482</u>	<u>\$ 1,894</u>	<u>\$ 3,787</u>	<u>\$ 3,310</u>	<u>\$ 659</u>	<u>\$ 214</u>

## 10. Commitments and Contingencies

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

### Securities Action

On March 4, 2016, a complaint was filed in the Superior Court for the State of Arizona against the Company and certain of its directors and officers on behalf of a purported class of purchasers of shares of the Company's common stock in the Company's underwritten secondary public offering which closed on March 10, 2015 (the "March 2015 Offering"). The complaint purports to state claims under Sections 11, 12 and 15 of the Securities Act of 1933, as amended, based on an alleged failure by the Company to disclose adequate information about produce price deflation in the March 2015 Offering documents. The complaint seeks damages on behalf of the purported class in an unspecified amount, rescission, and an award of reasonable costs and attorneys' fees. On March 24, 2016, the Company removed the action to federal court in the District of Arizona. On April 18, 2016, the Company filed a motion to remand the case to state court, and that motion is currently under consideration. The Company intends to defend this case vigorously, but it is not possible at this time to reasonably estimate the outcome of, or any potential liability from, the case.

## 11. Stockholders' Equity

### Share Repurchase

On November 4, 2015, the Company's board of directors authorized a \$150 million share repurchase program for its common stock. The shares may be purchased from time to time over a two-year period, subject to general business and market conditions and other investment opportunities, through open market purchases, privately negotiated transactions or other means, including through Rule 10b5-1 trading plans. The board's authorization of the share repurchase program does not obligate the Company to acquire any particular amount of common stock, and the repurchase program may be commenced, suspended or discontinued at any time. During the thirteen weeks ended July 3, 2016, the Company repurchased 2,547,971 shares of common stock for \$65.0 million and subsequently retired such shares. The Company did not repurchase any shares during the thirteen weeks ended June 28, 2015. During the twenty-six weeks ended July 3, 2016, the Company repurchased 4,979,692 shares of common stock for \$124.3 million. The Company did not repurchase any shares during the twenty-six weeks ended June 28, 2015. During the thirteen weeks ended July 3, 2016, the \$150 million share repurchase program was completed.

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

**12. Net Income Per Share**

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

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		Twenty-Six Weeks Ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
<b>Basic net income per share:</b>				
Net income	\$ 37,209	\$ 31,322	\$ 83,416	\$ 68,789
Weighted average shares outstanding	149,170	153,393	149,931	152,814
Basic net income per share	\$ 0.25	\$ 0.20	\$ 0.56	\$ 0.45
<b>Diluted net income per share:</b>				
Net income	\$ 37,209	\$ 31,322	\$ 83,416	\$ 68,789
Weighted average shares outstanding	149,170	153,393	149,931	152,814
Dilutive effect of equity-based awards:				
Assumed exercise of options to purchase shares	2,289	2,552	2,321	2,884
RSUs	8	4	44	30
PSAs	31	—	26	
Weighted average shares and equivalent shares outstanding	151,498	155,949	152,322	155,728
Diluted net income per share	\$ 0.25	\$ 0.20	\$ 0.55	\$ 0.44

For the thirteen weeks ended July 3, 2016, the computation of diluted net income per share does not include 1.3 million options, 0.1 million RSUs, and 0.1 million PSAs as those awards would have been antidilutive or were unvested performance awards. For the thirteen weeks ended June 28, 2015, the computation of diluted net income per share does not include 0.8 million options, as those options would have been antidilutive or were unvested performance-based options, 0.1 million RSUs as those RSUs would have been antidilutive and 0.1 million PSAs.

For the twenty-six weeks ended July 3, 2016, the computation of diluted net income per share does not include 1.3 million options, 0.1 million RSUs, 0.1 million PSAs, and 0.2 million restricted stock awards ("RSAs") as those awards would have been antidilutive or were unvested performance awards. For the twenty-six weeks ended June 28, 2015, the computation of diluted net income per share does not include 0.8 million options, as those options would have been antidilutive or were unvested performance-based options and 0.1 million PSAs.

**13. Equity-Based Compensation**

**2013 Incentive Plan**

The Company's board of directors adopted, and its equity holders approved, the Sprouts Farmers Market, Inc. 2013 Incentive Plan (the "2013 Incentive Plan"). The 2013 Incentive Plan became effective July 31, 2013 in connection with the Company's initial public offering and replaced the Sprouts Farmers Markets, LLC Option Plan (the "2011 Option Plan") (except with respect to outstanding options to acquire shares under the 2011 Option Plan). The 2013 Incentive Plan 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. On May 1, 2015, the Company's stockholders approved the material terms of the performance goals under the 2013 Incentive Plan for purposes of Section 162(m) of the Internal Revenue Code.

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

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. At July 3, 2016, there were 3,621,684 stock awards outstanding.

**2011 Option Plan**

In May 2011, the Company adopted the 2011 Option Plan to provide team members or directors of the Company with options to acquire shares of the Company. The Company had authorized 12,100,000 shares for issuance under the 2011 Option Plan. Options may no longer be issued under the 2011 Option Plan. At July 3, 2016, there were 3,895,713 options outstanding under the 2011 Option Plan.

**Awards Granted**

During the twenty-six weeks ended July 3, 2016, the Company granted the following stock-based compensation awards:

<u>Grant Date</u>	<u>Stock Options</u>	<u>RSUs</u>	<u>PSAs</u>	<u>RSAs</u>
March 4, 2016	318,156	213,767	92,942	—
April 11, 2016	4,627	1,335	—	—
May 9, 2016	—	14,404	—	—
May 23, 2016	419,935	—	—	217,852
<b>Total:</b>	<b>742,718</b>	<b>229,506</b>	<b>92,942</b>	<b>217,852</b>
<i>Weighted-average grant date fair value</i>	\$ 7.43	\$ 28.11	\$ 28.21	\$ 24.48
<i>Weighted-average exercise price</i>	\$ 26.10	—	—	—

**Options**

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

Time-based options granted prior to 2016 generally vest ratably over a period of 12 quarters (three years), and time-based options granted in 2016 vest annually over a period of three years.

**RSUs**

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

**PSAs**

PSAs granted in 2015 are restricted shares that were subject to the Company achieving certain earnings per share performance targets, as well as additional time-vesting conditions. The fair value of PSAs is based on the closing price of the Company's common stock on the grant date. The performance conditions with respect to 2015 earnings per share were deemed to have been met, and the PSAs will vest 50 percent at each of the second and third anniversary of the grant date.

PSAs granted in 2016 are restricted shares that are subject to the Company achieving certain earnings before interest and taxes ("EBIT") performance targets on an annual and cumulative basis over a three-year performance period, as well as additional time-vesting conditions. The fair value of these PSAs is based on the closing price of the Company's common stock on the grant date. The EBIT target resets annually for each of the three years during the performance period based on a percentage increase over the previous year's actual EBIT, with each annual performance tranche independent of the previous and next tranche. Cumulative performance is based on the aggregate annual performance

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

targets. Payout of the performance shares will either be 0% or range from 50% to 150% of the target number of shares granted. If the performance conditions are met, PSAs cliff vest on the third anniversary of the grant date.

**RSA**s

The fair value of RSAs is based on the closing price of the Company's common stock on the grant date. RSAs will vest either ratably over a seven quarter period, beginning on December 31, 2016 or cliff vest on June 30, 2018.

**Equity Award Revisions**

In connection with the appointments of the Company's Chief Executive Officer and President & Chief Operating Officer in August 2015, the Compensation Committee of the Company's Board of Directors approved a grant of stock options to purchase 1,200,000 and 500,000 shares of the Company's common stock at an exercise price of \$20.98 per share to these officers, respectively (the "August 2015 Options") pursuant to the 2013 Incentive Plan. The August 2015 Options, taken together with other options granted under the 2013 Incentive Plan to such officers during 2015, exceeded the limit of 500,000 shares which may be granted pursuant to stock options and stock appreciation rights per calendar year to each participant under the 2013 Incentive Plan by 733,439 shares in the case of the Company's Chief Executive Officer and 33,439 shares in the case of the Company's President & Chief Operating Officer (the "Excess Options"). Accordingly, the Company has determined, and these officers have acknowledged, that the grants of the Excess Options were null and void.

In order to satisfy the original intent with respect to these individuals' compensation, on May 23, 2016, the Compensation Committee granted to the Company's Chief Executive Officer and President & Chief Operating Officer under the 2013 Incentive Plan options to purchase 386,496 and 33,439 shares of the Company's common stock at an exercise price of \$24.48 per share, respectively, and 215,251 and 2,601 RSAs, respectively. The Company recognized compensation expense of \$0.4 million during the thirteen weeks ended July 3, 2016 related to the options and RSAs granted.

**Equity-based Compensation Expense**

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
Cost of sales, buying and occupancy	\$ 264	\$ 130	\$ 482	\$ 231
Direct store expenses	359	284	676	467
Selling, general and administrative expenses	3,045	878	5,167	1,736
Equity-based compensation expense before income taxes	3,668	1,292	6,325	2,434
Income tax benefit	(1,394)	(504)	(2,403)	(950)
Net equity-based compensation expense	<u>\$ 2,274</u>	<u>\$ 788</u>	<u>\$ 3,922</u>	<u>\$ 1,484</u>

The following equity-based awards were outstanding as of July 3, 2016 and January 3, 2016:

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

	As of	
	July 3, 2016 (in thousands)	January 3, 2016 (in thousands)
Options		
Vested	5,282	5,287
Unvested	1,576	2,116
RSUs	282	143
PSAs	159	70
RSAs	218	0

As of July 3, 2016 total unrecognized compensation expense related to outstanding equity-based awards was as follows:

	As of July 3, 2016
Options	\$ 10,886
RSUs	6,960
PSAs	3,358
RSAs	5,048
Total unrecognized compensation expense	<u>\$ 26,252</u>

As of July 3, 2016, the total remaining weighted average life (in years) related to outstanding equity-based awards was as follows:

	As of July 3, 2016
Options	2.0
RSUs	1.9
PSAs	2.1
RSAs	2.0

During the twenty-six weeks ended July 3, 2016 and June 28, 2015, the Company received \$2.1 million and \$6.2 million, respectively, in cash proceeds from the exercise of options.

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

*You should read the following discussion of our financial condition and results of operations in conjunction with the consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K filed February 25, 2016 with the Securities and Exchange Commission. All dollar amounts included below are in thousands, unless otherwise noted.*

### **Business Overview**

Sprouts Farmers Market operates as a healthy grocery store that offers fresh, natural and organic food that includes fresh produce, bulk foods, vitamins and supplements, grocery, meat and seafood, deli, 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 240 stores in 13 states as of July 3, 2016, we are one of the largest specialty retailers of fresh, natural and organic food in the United States.

At Sprouts, we believe healthy living is a journey and every meal is a choice. 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 featuring a broad selection of innovative healthy products, and knowledgeable team members who we believe provide best-in-class customer engagement and product education.

*Healthy Living for Less.* We offer high-quality, fresh, natural and organic products at attractive prices in every department. Consistent with our farmers market heritage, our offering begins with fresh produce, which we source, warehouse and distribute in-house and sell at prices we believe to be significantly below those of other food retailers. In addition, our scale, operating structure and deep industry relationships position us to consistently deliver competitive prices and promote value throughout the store. 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. 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 28,000 to 30,000 sq. ft.), our stores have a farmers market feel, with a bright, open-air atmosphere to create a comfortable and engaging in-store experience. We strive to be our customers' everyday healthy grocery store. We feature fresh produce and bulk foods at the center of the store surrounded by a complete grocery offering. Consistent with our fresh, 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, and innovative healthier alternatives that emphasize our focus on fresh, natural and organic products at great values.

*Customer Engagement and Education.* Our commitment to "Healthy Living for Less" is shared by team members throughout the entire organization who are dedicated to our passion for educating and engaging with our customers with the goal of making healthy eating easier and more accessible. We believe our well-trained and engaged team members, as well as the materials we disseminate through our digital and social media platforms, help our customers increasingly understand that they can purchase a wide selection of high-quality, healthy, and great tasting food for themselves and their families at attractive prices by shopping at Sprouts.

### **Outlook**

We are pursuing a number of strategies designed to continue our growth, including expansion of our store base, continuing positive comparable store sales growth 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 27 stores and relocated one

store during 2015. We expect to continue to expand our store base with 36 store openings planned in fiscal 2016, of which 26 have opened as of the date of this Quarterly Report on Form 10-Q. 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 aim to achieve 14% annual new store growth for at least the next five years.

We also believe we can continue to improve our comparable store sales growth by enhancing our core value proposition and distinctive customer-oriented shopping experience, as well as through expanding and refining our fresh, natural and organic product offerings, our targeted and personalized marketing efforts and our in-store education. We 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.

### **Our History**

In 2002, we opened the first Sprouts Farmers Market store in Chandler, Arizona. From our founding in 2002 through January 3, 2016, we continued to open new stores while successfully rebranding 43 Henry's Farmers Market (referred to as "Henry's") and 39 Sunflower Farmers Market (referred to as "Sunflower") stores added through acquisitions to the Sprouts banner (referred to as the "Transactions"). These three businesses all trace their lineage back to Henry's Farmers Market and were built with similar store formats and operations including a strong emphasis on value, produce and service in smaller, convenient locations. The consistency of these formats and operations was an important factor that allowed us to rapidly and successfully rebrand and integrate each of these businesses under the Sprouts banner and on a common platform. Since our August 2013 initial public offering, we have continued to expand, adding stores in our existing markets and extending into Kansas, Georgia, Missouri, Alabama and Tennessee.

### **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 second quarters of fiscal 2016 and 2015 were thirteen-week periods ended July 3, 2016 and June 28, 2015, 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. In the second quarter of 2015, we determined that we had sufficient data to estimate gift card breakage. We record an allowance for breakage on gift cards based on historical experience. We do not include sales taxes in net sales.

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

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

- general economic conditions and trends, including levels of disposable income and consumer confidence;
- consumer preferences and buying trends;

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

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

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

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

Gross profit is equal to our net sales less our cost of sales, buying and occupancy. Gross margin is gross profit as a percentage of our net sales.

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

***Direct store expenses***

Direct store expenses consist of store-level expenses such as salaries and benefits, related equity-based compensation, supplies, depreciation and amortization for buildings, store leasehold improvements, equipment and other store specific costs.

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

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

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

***Store pre-opening costs***

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

***Store closure and exit costs***

We recognize a reserve for future operating lease payments and other occupancy costs associated with facilities that are no longer being utilized in our current operations. The reserve is

recorded based on the present value of the remaining non-cancelable lease payments and estimates of other occupancy costs after the cease use date less a discounted estimate of subtenant income. If subtenant income is expected to be higher than the lease payments, no accrual is recorded. Lease payments and other occupancy costs included in the closed facility 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 facility reserve relate primarily to changes in actual or estimated subtenant income and changes in actual lease payments and other occupancy costs from original estimates. Adjustments are made for changes in estimates in the period in which the change becomes known, considering timing of new information regarding market, subleases or other lease updates. Changes in reserve estimates are classified as store closure and exit costs in the consolidated statements of operations.

***Provision for income taxes***

We must make certain estimates and judgments in determining income tax expense for financial statement purposes. The amount of taxes currently payable or refundable is accrued and deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Deferred tax assets are also recognized for realizable loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in our financial statements in the period that includes the enactment date.

## Results of Operations for Thirteen Weeks Ended July 3, 2016 and June 28, 2015

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

	Thirteen weeks ended	
	July 3, 2016	June 28, 2015
<b>Unaudited Quarterly Consolidated Statement of Operations Data:</b>		
Net sales	\$ 1,031,643	\$ 902,153
Cost of sales, buying and occupancy	725,841	638,514
Gross profit	305,802	263,639
Direct store expenses	207,107	177,381
Selling, general and administrative expenses	30,922	23,390
Store pre-opening costs	4,213	2,507
Store closure and exit costs	98	315
Income from operations	63,462	60,046
Interest expense	(3,661)	(4,437)
Other income	90	112
Loss on extinguishment of debt	—	(5,481)
Income before income taxes	59,891	50,240
Income tax provision	(22,682)	(18,918)
Net income	<u>\$ 37,209</u>	<u>\$ 31,322</u>

	Thirteen weeks ended	
	July 3, 2016	June 28, 2015
<b>Comparable store sales growth(1)</b>	4.1%	5.1%

### Other Operating Data:

Stores at beginning of period	228	200
Opened	12	8
Stores at end of period	<u>240</u>	<u>208</u>

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

### Comparison of Thirteen Weeks Ended July 3, 2016 to Thirteen Weeks Ended June 28, 2015

#### Net sales

	Thirteen weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Net sales	\$ 1,031,643	\$ 902,153	\$ 129,490	14%
Comparable store sales growth	4.1%	5.1%		

Net sales for the thirteen weeks ended July 3, 2016 totaled \$1.0 billion, increasing 14% over the same period of the prior fiscal year. Sales growth was driven by solid performance in new stores opened and increases in comparable stores sales. Comparable stores contributed approximately 88% of total sales for the thirteen weeks ended July 3, 2016 and approximately 85% for the same period of the prior fiscal year.

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

	Thirteen weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Net sales	\$ 1,031,643	\$ 902,153	\$ 129,490	14%
Cost of sales, buying and occupancy	725,841	638,514	87,327	14%
Gross profit	305,802	263,639	42,163	16%
Gross margin	29.6%	29.2%	0.4%	

Cost of sales, buying and occupancy increased during the thirteen weeks ended July 3, 2016 compared to the thirteen weeks ended June 28, 2015, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. Gross profit increased \$37.9 million as a result of increased sales volume, and \$4.3 million related to increased margin. The gross margin increase is due to higher margins in certain categories primarily due to deflation and improved shrink.

### **Direct store expenses**

	Thirteen weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Direct store expenses	\$ 207,107	\$ 177,381	\$ 29,726	17%
Percentage of net sales	20.1%	19.7%	0.4%	

Direct store expenses increased \$29.7 million, primarily due to stores opened since June 28, 2015, as well as increases in direct store expenses associated with stores operated prior to June 28, 2015. Direct store expenses, as a percentage of net sales, increased 40 basis points primarily due to higher payroll expense from planned wage increases and increased training costs.

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

	Thirteen weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Selling, general and administrative expenses	\$ 30,922	\$ 23,390	\$ 7,532	32%
Percentage of net sales	3.0%	2.6%	0.4%	

The increase in selling, general and administrative expenses included \$2.2 million in equity-based compensation expense primarily due to additional grants related to management transitions during 2015, \$1.6 million in advertising to support new stores, \$1.3 million in corporate payroll to support growth, \$0.2 million in consulting for strategic initiatives, \$0.7 million for bonus expense and other less significant increases in expense.

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

Store pre-opening costs were \$4.2 million for the thirteen weeks ended July 3, 2016 and \$2.5 million for the thirteen weeks ended June 28, 2015. Store pre-opening costs in the thirteen weeks ended July 3, 2016 included \$2.5 million related to opening 12 stores during that period and \$1.7 million associated with stores expected to open subsequent to quarter end. The expense for stores expected to open subsequent to quarter end includes rent paid for certain acquired leases prior to the store opening. Store pre-opening costs in the thirteen weeks ended June 28, 2015 included \$1.8 million related to opening 8 stores during that period and \$0.7 million associated with stores expected to open subsequent to quarter end.

### **Interest expense**

Interest expense decreased to \$3.7 million for the thirteen weeks ended July 3, 2016 from \$4.4 million for the thirteen weeks ended June 28, 2015. The decrease in interest expense is due to lower principal balance on the Credit Facility.

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

In the thirteen weeks ended June 28, 2015, we recorded a loss on extinguishment of debt totaling \$5.5 million related to the write-off of deferred financing costs and issue discount in the April 2015 Refinancing.

### **Income tax provision**

Income tax provision increased to \$22.7 million for the thirteen weeks ended July 3, 2016 from \$18.9 million for the thirteen weeks ended June 28, 2015, mainly related to an increase in income before income taxes. Our effective income tax rate was 37.9% in the thirteen weeks ended July 3, 2016 and 37.7% in the thirteen weeks ended June 28, 2015.

### **Net income**

	Thirteen weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Net income	\$ 37,209	\$ 31,322	\$ 5,887	19%
Percentage of net sales	3.6%	3.5%	0.1%	

Net income growth was driven by sales growth, increased gross margin and reduced interest expense, offset by increased store payroll and selling, general and administrative expense.

### **Results of Operations for Twenty-Six Weeks Ended July 3, 2016 and June 28, 2015**

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

	Twenty-six weeks ended	
	July 3, 2016	June 28, 2015
<b>Unaudited Quarterly Consolidated Statement of Operations</b>		
<b>Data:</b>		
Net sales	\$ 2,024,884	\$ 1,759,659
Cost of sales, buying and occupancy	1,412,569	1,238,227
Gross profit	612,315	521,432
Direct store expenses	400,885	340,571
Selling, general and administrative expenses	61,818	47,417
Store pre-opening costs	8,179	5,280
Store closure and exit costs	135	1,544
Income from operations	141,298	126,620
Interest expense	(7,262)	(10,305)
Other income	191	174
Loss on extinguishment of debt	—	(5,481)
Income before income taxes	134,227	111,008
Income tax provision	(50,811)	(42,219)
Net income	\$ 83,416	\$ 68,789

	Twenty-six weeks ended	
	July 3, 2016	June 28, 2015
<b>Comparable store sales growth(1)</b>	4.4%	4.9%
<b>Other Operating Data:</b>		
Stores at beginning of period	217	191
Closed	—	(1)
Opened	23	18
Stores at end of period	240	208

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

### Comparison of Twenty-Six Weeks Ended July 3, 2016 to Twenty-Six Weeks Ended June 28, 2015

#### Net sales

	Twenty-six weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Net sales	\$ 2,024,884	\$ 1,759,659	\$ 265,225	15%
Comparable store sales growth	4.4%	4.9%		

Net sales for the twenty-six weeks ended July 3, 2016 totaled \$2.0 billion, increasing 15% over the same period of the prior fiscal year. Sales growth was driven by solid performance in new stores opened and increases in comparable stores sales. Comparable stores contributed approximately 88% of total sales for the twenty-six weeks ended July 3, 2016 and approximately 86% for the same period of the prior fiscal year.

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

	Twenty-six weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Net sales	\$ 2,024,884	\$ 1,759,659	\$ 265,225	15%
Cost of sales, buying and occupancy	1,412,569	1,238,227	174,342	14%
Gross profit	612,315	521,432	90,883	17%
Gross margin	30.2%	29.6%	0.6%	

Cost of sales, buying and occupancy increased during the twenty-six weeks ended July 3, 2016 compared to the twenty-six weeks ended June 28, 2015, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. Gross profit increased \$78.6 million as a result of increased sales volume, and \$12.3 million related to increased margin. The gross margin increase is due to higher margins in certain categories primarily due to deflation.

#### Direct store expenses

	Twenty-six weeks ended		Change	% Change
	July 3, 2016	June 28, 2015		
Direct store expenses	\$ 400,885	\$ 340,571	\$ 60,314	18%
Percentage of net sales	19.8%	19.4%	0.4%	

Direct store expenses increased \$60.3 million, primarily due to stores opened since June 28, 2015, as well as increases in direct store expenses associated with stores operated prior to June 28, 2015. Direct store expenses, as a percentage of net sales, increased 40 basis points primarily due to higher

payroll expense from planned wage increases and increased training costs, partially offset by timing of the New Year's holiday payroll.

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

	<u>Twenty-six weeks ended</u>		<u>Change</u>	<u>% Change</u>
	<u>July 3, 2016</u>	<u>June 28, 2015</u>		
Selling, general and administrative expenses	\$ 61,818	\$ 47,417	\$ 14,401	30%
Percentage of net sales	3.1%	2.7%	0.4%	

The increase in selling, general and administrative expenses included \$3.7 million in advertising to support new stores, \$3.4 million in equity-based compensation expense due to additional grants related to management transitions during 2015, \$2.3 million in corporate payroll to support growth, \$0.8 million in consulting for strategic initiatives, and other less significant increases in expense.

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

Store pre-opening costs were \$8.2 million for the twenty-six weeks ended July 3, 2016 and \$5.3 million for the twenty-six weeks ended June 28, 2015. Store pre-opening costs in the twenty-six weeks ended July 3, 2016 included \$5.7 million related to opening 23 stores during the twenty-six weeks and \$2.5 million associated with stores expected to open subsequent to quarter end. The expense for stores expected to open subsequent to quarter end includes rent paid for certain acquired leases prior to the store openings. Store pre-opening costs in the twenty-six weeks ended June 28, 2015 included \$4.7 million related to opening 18 stores during that period and \$0.6 million associated with stores expected to open subsequent to quarter end.

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

Store closure and exit costs of \$1.5 million for the twenty-six weeks ended June 28, 2015 includes \$1.1 million for the relocation of our support office and adjustments for prior reserves.

### ***Interest expense***

Interest expense decreased to \$7.3 million for the twenty-six weeks ended July 3, 2016 from \$10.3 million for the twenty-six weeks ended June 28, 2015. The decrease in interest expense is due to the lower principal balances on both the current Credit Facility and the Company's former revolving credit Facility combined with the lower interest rate on our Credit Facility after the April 2015 Refinancing.

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

In the twenty-six weeks ended June 28, 2015, we recorded a loss on extinguishment of debt totaling \$5.5 million related to the write-off of deferred financing costs and issue discount in the April 2015 Refinancing.

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

Income tax provision increased to \$50.8 million for the twenty-six weeks ended July 3, 2016 from \$42.2 million for the twenty-six weeks ended June 28, 2015, mainly related to an increase in income before income taxes. Our effective income tax rate decreased to 37.9% in the twenty-six weeks ended July 3, 2016 from 38.0% in the twenty-six weeks ended June 28, 2015. The decrease in the effective tax rate is mainly related to an increase in the enhanced deduction for charitable donations of food inventory and an increase in tax credits, partially offset by an increase in the effective state income tax rate.

## Net income

	Twenty-six weeks ended			
	July 3, 2016	June 28, 2015	Change	% Change
Net income	\$ 83,416	\$ 68,789	\$ 14,627	21%
Percentage of net sales	4.1%	3.9%	0.2%	

Net income growth was driven by sales growth, increased gross margin and reduced interest expense and loss on extinguishment of debt in prior year, offset by increases in advertising expense to support our growth, payroll and equity-based compensation.

## 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:

	Twenty-six weeks ended	
	July 3, 2016	June 28, 2015
Cash and cash equivalents at end of period	\$ 78,444	\$ 97,258
Cash flows from operating activities	\$ 147,940	\$ 120,940
Cash flows used in investing activities	\$ (84,910)	\$ (74,539)
Cash flows used in financing activities	\$ (120,655)	\$ (79,656)

We have generally financed our operations principally through cash generated from operations and borrowings under our credit facilities. Our primary uses of cash are for purchases of inventory, operating expenses, capital expenditures primarily for opening new stores, remodel and maintenance capital expenditures, and debt service. We believe that our existing cash and cash equivalents, and cash anticipated to be generated from operations will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including new store openings, remodel and maintenance capital expenditures at existing stores, store initiatives and other corporate capital expenditures and activities. Our cash and cash equivalents position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within days from the related sale.

### Operating activities

Cash flows from operating activities increased \$27.0 million to \$147.9 million for the twenty-six weeks ended July 3, 2016 compared to \$120.9 million for the twenty-six weeks ended June 28, 2015. The increase in operating cash flow is primarily due to the growth in cash flows from existing stores and from new stores opened since the second quarter of 2015.

### Investing activities

Cash flows used in investing activities was \$84.9 million for the twenty-six weeks ended July 3, 2016 compared to \$74.5 million for the twenty-six weeks ended June 28, 2015.

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

We expect capital expenditures to be in the range of \$155 - \$165 million in fiscal 2016, including expenditures incurred to date, net of estimated landlord tenant improvement allowances, primarily to fund investments in new stores, remodels, maintenance capital expenditures and corporate capital expenditures. We expect to fund our capital expenditures with cash on hand, cash generated from operating activities and, if required, borrowings under our Credit Facility.

### Financing activities

Cash flows used in financing activities was \$120.7 million for the twenty-six weeks ended July 3, 2016 compared to cash used in financing activities of \$79.7 million for the twenty-six weeks ended June 28, 2015. The increase in cash used in financing activities of \$41.0 million is related to \$124.3 million of stock repurchases which completed the \$150 million share purchase authorization, a \$15.6 million decrease resulting from excess tax benefits from the exercise of stock options, a \$4.2 million decrease resulting from proceeds from the exercise of stock options and a \$1.9 million decrease resulting from cash from landlord related to financing lease obligations. These increases in cash used in financing activities were offset by a decrease resulting from the net paydown of debt of \$101.2 million in the twenty-six weeks ended June 28, 2015.

### Long-Term debt and credit facilities

See Note 6 "Long-Term Debt" of our unaudited consolidated financial statements for a description of our Credit Facility and our former credit facility.

### Contractual Obligations

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

The following table summarizes our lease obligations as of July 3, 2016, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years (in thousands)	4-5 Years	More Than 5 Years
Capital and financing lease obligations(1)	\$ 140,977	\$ 15,363	\$ 31,417	\$ 29,868	\$ 64,329
Operating lease obligations(1)	1,344,624	116,548	252,414	239,213	736,449
Totals	<u>\$ 1,485,601</u>	<u>\$ 131,911</u>	<u>\$ 283,831</u>	<u>\$ 269,081</u>	<u>\$ 800,778</u>

(1) Represents estimated payments for capital and financing and operating lease obligations as of July 3, 2016. Capital and financing lease obligations and operating lease obligations are presented gross without offset for subtenant rentals. We have subtenant agreements under which we will receive \$1.6 million for the period of less than one year, \$2.4 million for years one to three, \$1.8 million for years four to five, and \$2.0 million for the period beyond five years.

We have other contractual commitments and debt, which were presented under Contractual Obligations in our Annual Report on Form 10-K for the fiscal year ended January 3, 2016, and for which there have not been material changes since that filing through July 3, 2016. As discussed in Note 6 to the unaudited consolidated financial statements, we entered into the Credit Facility with an initial balance of \$260.0 million which will mature in April 2020. As of July 3, 2016, the outstanding balance on the Revolving Credit Facility was \$160.0 million.

### Off-Balance Sheet Arrangements

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

### Impact of Inflation

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

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

### **Seasonality**

Our business is subject to modest seasonality. Our average weekly sales fluctuate throughout the year and are typically highest in the first half of the fiscal year. Produce, which contributed approximately 25% of our net sales for the thirteen weeks ended July 3, 2016, is generally more available in the first six months of our fiscal year due to the timing of peak growing seasons.

### **Critical Accounting Estimates**

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

There have been no substantial changes to these estimates or the policies related to them during the twenty-six weeks ended July 3, 2016. For a full discussion of these estimates and policies, see "Critical Accounting Estimates" in Item 7 of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016.

### **Recently Issued Accounting Pronouncements**

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

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

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

As described in Note 6, "Long-Term Debt" to our unaudited consolidated financial statements located elsewhere in this Quarterly Report on Form 10-Q, we have a Credit Facility that bears interest at a rate based in part on LIBOR. Accordingly, we are exposed to fluctuations in interest rates. Based on the \$160.0 million principal outstanding under our Credit Facility as of July 3, 2016, each hundred basis point change in LIBOR would result in a change in interest expense by \$1.6 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.

### **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) under the Exchange Act) designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and

reported within the time period specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to our management, including our Chief Executive Officer (our principal executive officer) and our Chief Financial Officer (our principal financial officer), as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures under the Exchange Act as of July 3, 2016, 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 effective.

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

During the quarterly period ended July 3, 2016, there were no changes in our internal controls over financial reporting that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings.

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

#### **Securities Action**

On March 4, 2016, a complaint was filed in the Superior Court for the State of Arizona against the Company and certain of its directors and officers on behalf of a purported class of purchasers of shares of the Company's common stock in the Company's underwritten secondary public offering which closed on March 10, 2015 (the "March 2015 Offering"). The complaint purports to state claims under Sections 11, 12 and 15 of the Securities Act of 1933, as amended, based on an alleged failure by the Company to disclose adequate information about produce price deflation in the March 2015 Offering documents. The complaint seeks damages on behalf of the purported class in an unspecified amount, rescission, and an award of reasonable costs and attorneys' fees. On March 24, 2016, the Company removed the action to federal court in the District of Arizona. On April 18, 2016, the plaintiffs filed a motion to remand the case to state court, and that motion is currently under consideration. The Company intends to defend this case vigorously, but it is not possible at this time to reasonably estimate the outcome of, or any potential liability from, the case.

#### **"Phishing" Scam Actions**

In April 2016, four complaints were filed, two in the federal courts of California, one in the Superior Court of California and one in the federal court in the District of Colorado, each on behalf of a purported class of current and former Company team members whose personally identifiable information ("PII") was inadvertently disclosed to an unauthorized third party that perpetrated an email "phishing" scam against a Company team member. The complaints allege the Company failed to properly safeguard the PII in accordance with applicable law. The complaints seek damages on behalf of the purported class in unspecified amounts, attorneys' fees and litigation expenses. All four cases are currently stayed pending a ruling on a motion filed in June 2016 before the Judicial Panel on Multidistrict Litigation to transfer and consolidate all of the cases to the federal court in the District of Arizona. The Company intends to defend these cases vigorously, but it is not possible at this time to reasonably estimate the outcome of, or any potential liability from, the cases.

### Item 1A. Risk Factors.

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

There have been no material changes to the Risk Factors described under "Part I – Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended January 3, 2016.

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

#### **Issuer Purchases of Equity Securities**

The following table provides information about our share repurchase activity during the thirteen weeks ended July 3, 2016.

Period (1)	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (2)	Approximate dollar value of shares that may yet be purchased under the plans or programs (2)
April 4, 2016 - May 1, 2016	—	\$ —	—	\$ —
May 2, 2016 - May 29, 2016	2,547,971	25.47	2,547,971	—
May 30, 2016 - July 3, 2016	—	—	—	—
<b>Total</b>	<b>2,547,971</b>	<b>\$ 25.47</b>	<b>2,547,971</b>	<b>\$ —</b>

(1) Periodic information is presented by reference to our fiscal periods during the second quarter of fiscal year 2016.

(2) On November 4, 2015, our Board of Directors authorized a \$150 million share repurchase program of our common stock. The shares may be purchased from time to time over a two year period, subject to general business and market conditions and other investment opportunities, through open market purchases, privately negotiated transactions or other means, including through Rule 10b5-1 trading plans. During the thirteen weeks ended July 3, 2016, the \$150 million share repurchase program was completed.

#### Item 6. Exhibits.

Exhibit Number	Description
101.†	Deli, Cheese, and Bakery Distribution Agreement, dated as of February 12, 2016, by and between SFM, LLC dba Sprouts Farmers Market and KeHE Distributors, LLC
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

† Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a confidential treatment request submitted separately to the SEC pursuant to Rule 406 under the Securities Act. This exhibit is being refiled by the registrant in response to comments from the SEC's staff with respect to the confidential treatment request.

**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: August 4, 2016

By: /s/ Bradley S. Lukow

Name: Bradley S. Lukow

Title: Chief Financial Officer  
(Principal Financial Officer)

## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
10.1†	Deli, Cheese, and Bakery Distribution Agreement, dated as of February 12, 2016, by and between SFM, LLC dba Sprouts Farmers Market and KeHE Distributors, LLC
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

† Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a confidential treatment request submitted separately to the SEC pursuant to Rule 406 under the Securities Act. This exhibit is being refiled by the registrant in response to comments from the SEC's staff with respect to the confidential treatment request.

32

[\(Back To Top\)](#)

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

### Exhibit 10.1

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



### DELI, CHEESE, AND BAKERY DISTRIBUTION AGREEMENT

This Deli, Cheese, and Bakery Distribution Agreement ("Agreement"), is made effective as of February 12<sup>th</sup>, 2016 (the "Effective Date"), by and between SFM, LLC dba Sprouts Farmers Market ("SFM"), a Delaware limited liability company, and KeHE Distributors, LLC ("KeHE"), a Delaware limited liability company.

### RECITALS

WHEREAS, SFM and KeHE, through KeHE's wholly-owned subsidiary Nature's Best, are parties to that certain Amended and Restated Distribution Agreement dated August 13, 2014 ("NB Agreement");

WHEREAS, Monterrey Provision Co. Inc. ("MPC") currently supplies various deli and other food products to SFM on terms negotiated between MPC and SFM;

WHEREAS, contemporaneous with the execution of this Agreement, KeHE has entered into an agreement to purchase substantially all of the assets of MPC; and

WHEREAS, KeHE's agreement to purchase MPC is contingent upon SFM's agreement to name KeHE as the Primary Supplier, as defined below, of Deli, Cheese, and Bakery products (the "Products") under the terms set forth in this Agreement.

THEREFORE, in consideration of the mutual covenants set forth herein and other good and valuable consideration, the receipt of which is hereby acknowledged, the parties hereto mutually agree as follows:

### **ASSUMPTIONS**

A. SFM is engaged in the sale of the Products in a farmers' market grocery store format (the "SFM Stores"). Its operations include retail stores and distribution centers. SFM currently operates in several regions, including Alabama, Arizona, California, Missouri, Nevada, New Mexico, Utah, Georgia, Kansas, Tennessee, Texas, Oklahoma and Colorado.

B. KeHE has agreed to purchase substantially all of the assets of MPC, which provides the distribution of the Products to all SFM stores, and KeHE has agreed to continue to sell such Products to all SFM stores under the terms stated herein.

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

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

- 1) **TERM**: This Agreement shall have a term of three (3) years commencing on the Effective Date (the "Term").
- 2) **DISTRIBUTION AGREEMENT**:

- a. KeHE Distribution: KeHE will be SFM's Primary Supplier, as defined below, of the Products. SFM may maintain current distribution of all products currently supplied by **[\*CONFIDENTIAL\*]**, at SFM's discretion (the "**[\*CONFIDENTIAL\*]** Products"). A list of the **[\*CONFIDENTIAL\*]** Products is attached hereto as Schedule 1. SFM however agrees to work in good faith to transition its current supply of Products from **[\*CONFIDENTIAL\*]** (or its successors or affiliates) to KeHE within **[\*CONFIDENTIAL\*]** of the Effective Date. Pricing for additional items will be consistent with the Pricing set forth in Section 5.
  
- c. Primary Supplier shall be defined as follows:
  - i. All SFM stores will order a **[\*CONFIDENTIAL\*]** of their Products from KeHE (the "Supply Percentage"), which shall be subject to KeHE meeting the Minimum Fill Rate set forth in Section 3(c) below. SFM agrees to work in good faith with KeHE to increase the Supply Percentage during the Term to **[\*CONFIDENTIAL\*]**, provided KeHE is meeting the Minimum Fill Rate. Other than products distributed through its distribution facilities, SFM will source direct store delivery (DSD) deli, cheese, and bakery products carried in SFM stores, if available from KeHE, through KeHE, **[\*CONFIDENTIAL\*]**. SFM acknowledges that the pricing as of the Effective Date is considered competitive and that the preceding sentence shall not remove SFM's obligation to maintain KeHE as its Primary Supplier of the Products so long as **[\*CONFIDENTIAL\*]**. This does not include any products currently being distributed to SFM through **[\*CONFIDENTIAL\*]** as of the Effective Date, although the parties agree to work in good faith to determine if there is a mutually beneficial solution for supply of such products through KeHE.
  - ii. SFM will carry out commercially reasonable efforts to maintain a **[\*CONFIDENTIAL\*]**, adjusted annually according to changes in the Consumer Price Index.
  - iii. New Stores: If SFM opens new locations, KeHE shall become the Primary Supplier of the Products, as defined above, for such stores and SFM and KeHE shall work in good faith to ensure that **[\*CONFIDENTIAL\*]** and as reasonably acceptable to SFM.
  
- d. Cost Reduction Initiatives. KeHE and SFM will agree to work in good faith to modify business practices to reduce costs across the system. Both parties agree that any cost benefit achieved directly or indirectly by joint cost reduction practices will be **[\*CONFIDENTIAL\*]**.

3) **KeHE SUPPLIER PERFORMANCE:**

a. New Products:

- i. KeHE will stock all new products that are specifically requested by SFM and are placed chain wide (all SFM stores).
- ii. Regional product requests will be stocked if carried by all stores in the region, and there are reasonable aggregate product turns.

b. Phase 1 In Stock Level: During Phase 1, as defined in Section 5 below, KeHE shall maintain fill rates and practices consistent with MPC prior to the Effective Date. The annualized unadjusted MPC fill rate as of the Effective Date is **[\*CONFIDENTIAL\*]**, as reported by MPC.

c. Phase 2 In-Stock Level: During Phase 2 and 3, as defined in Section 5 below, KeHE and SFM will continue their mutual efforts to eliminate the causes of out-of- stock product in order to maintain the highest fill rate possible.

- i. KeHE will utilize its commercially reasonable efforts to maintain a KeHE controlled in-stock level (the "Fill Rate") of **[\*CONFIDENTIAL\*]** (the "Minimum Fill Rate") **[\*CONFIDENTIAL\*]**.
- ii. If at any point in time during the Term the average Minimum Fill Rate is not met for **[\*CONFIDENTIAL\*]** (a "Fill Rate Deficiency"), SFM shall notify KeHE of such, and KeHE shall have a cure period of **[\*CONFIDENTIAL\*]** to remedy such deficiency (the "Fill Rate Cure Period") **[\*CONFIDENTIAL\*]** (See Example 1 below).
- iii. If KeHE does not cure a Fill Rate Deficiency within the Fill Rate Cure Period (an "Uncured Deficiency"), KeHE shall reimburse SFM **[\*CONFIDENTIAL\*]** (a "Fill Rate Reimbursement") (See Example 2 below). If **[\*CONFIDENTIAL\*]** Uncured Deficiencies occur within a

**[\*CONFIDENTIAL\*]** period, the Fill Rate Reimbursement shall increase to **[\*CONFIDENTIAL\*]**.

**[\*CONFIDENTIAL\*]**

- iv. If the Uncured Deficiency is due to a Fill Rate Deficiency below **[\*CONFIDENTIAL\*]**, the Fill Rate Reimbursement shall **[\*CONFIDENTIAL\*]** for the deficiency under said **[\*CONFIDENTIAL\*]** and **[\*CONFIDENTIAL\*]** for the deficiency between **[\*CONFIDENTIAL\*]** and the Minimum Fill Rate.
- v. Notwithstanding the foregoing, in the event the Fill Rate is below **[\*CONFIDENTIAL\*]** for **[\*CONFIDENTIAL\*]**, SFM shall have the right, in addition to the Fill Rate Reimbursement, to terminate this Agreement and/or use another distributor to meet its demands (a “Right of Termination for Cause”). Upon exercise of a Right of Termination for Cause, if SFM opts to use another distributor, KeHE agrees to work diligently and in good faith with SFM to transfer the distribution of Products to the new supplier for up to **[\*CONFIDENTIAL\*]** (the “Transition Period”). During the Transition Period all terms under this Agreement shall continue in full force and effect, including but not limited to the service levels regarding distribution of Product and credits.

- vi. In the event that SFM opts to exercise its Right of Termination for Cause and switch to another supplier, as described above, for the Transition Period, KeHE shall be required to **[\*CONFIDENTIAL\*]**. Both SFM and KeHE agree to work in good faith to execute an orderly transition of business to SFM's designated new primary supplier that fairly treats both SFM and KeHE.
- vii. Notwithstanding the foregoing, if SFM opts not to terminate this Agreement per its Right of Termination for Cause, but still use another distributor to meet its demands, it shall work in good faith with KeHE to resume its distribution as Primary Supplier.
- viii. If the average monthly unadjusted in-stock level for any KeHE distribution facility (i.e., DC) falls below **[\*CONFIDENTIAL\*]** for **[\*CONFIDENTIAL\*]** (measured as the average Fill Rate for those **[\*CONFIDENTIAL\*]**), SFM shall notify KeHE of such, and KeHE shall have a cure period of **[\*CONFIDENTIAL\*]** to remedy such deficiency (measured as the average Fill Rate for the last **[\*CONFIDENTIAL\*]** of such cure period). If KeHE does not cure the deficiency within the cure period, KeHE shall reimburse SFM for **[\*CONFIDENTIAL\*]** of the difference between the actual fill rate (i.e., the deficient fill rate) (measured as the average of the **[\*CONFIDENTIAL\*]** of the cure period and **[\*CONFIDENTIAL\*]**) and a **[\*CONFIDENTIAL\*]** fill rate for that DC. This reimbursement shall be a remedy separate and apart from the Fill Rate Reimbursement set forth in Section 3.c.iii above.

4) **KeHE SPECIAL SERVICES:**

As of the Effective Date KeHE will continue to provide SFM with resources and support services consistent with those currently provided by the merchandising incentive program with MPC, to include new and existing store opening support (the "KeHE Special Services"). A basic description of the KeHE Special Services are attached hereto as Exhibit "B", which is subject to change in personnel and duties for each individual, provided KeHE agrees to provide the services set forth therein. These services shall be incremental to any program or distribution costs referenced in this Agreement and will remain in full force and payable under its current terms.

5) **COST PLUS RATE:**

- a. Phase 1 – During the initial **[\*CONFIDENTIAL\*]** period following the Effective Date, KeHE will continue to sell the Products to SFM described in Schedule 2 at the margins sold by MPC as of the Effective Date of this Agreement (the "Phase 1 Products"). New items will be sold at a rate of **[\*CONFIDENTIAL\*]**, including those Products transitioned from **[\*CONFIDENTIAL\*]**.

During Phase 1 KeHE will issue a **[\*CONFIDENTIAL\*]** rebate to SFM on all sales of all Products to SFM, which will be calculated as a percentage of the delivered cost of Products (i.e., net invoice cost of Products) in each respective market. All rebates will be paid within **[\*CONFIDENTIAL\*]**. Notwithstanding the foregoing, to the extent MPC has agreed to rebate SFM prior to the Effective Date of this Agreement, no additional rebate will be given to SFM over the aforementioned **[\*CONFIDENTIAL\*]** rebate.

- b. Phase 2 – Following the earlier of (i) Phase 1 (i.e., initial **[\*CONFIDENTIAL\*]**), or (ii) the conversion of shipments of the Products from each MPC facility to KeHE's facility, and continuing through the date that is the end of the **[\*CONFIDENTIAL\*]** following the Effective Date, the pricing for the Products shall be on a "cost plus" basis using the KeHE Cost (as defined below) for the Products, plus a mark-up of **[\*CONFIDENTIAL\*]** (the "Mark-Up"). "KeHE Cost" shall be defined as **[\*CONFIDENTIAL\*]**. Following Phase 1, KeHE Cost may be different for each individual KeHE distribution center based on **[\*CONFIDENTIAL\*]**. Delivery schedules for the Products will transition to the delivery frequency consistent with the terms under the NB Agreement. For avoidance of doubt if one MPC facility has converted to a KeHE facility prior to the end of the initial **[\*CONFIDENTIAL\*]** from the Effective Date, then the price shall be adjusted for that facility, but shall remain for any other MPC facilities that have not been converted until such time as the facility is converted, or the end of the initial **[\*CONFIDENTIAL\*]** of the Term. KeHE will make available full disclosure of freight costs associated with the calculation of the final delivered cost of all products if requested by SFM in order to validate true business costs. SFM and KeHE agree to work in good faith toward a complete integration of the MPC business into KeHE during the initial **[\*CONFIDENTIAL\*]** following the Effective Date.
  - c. Phase 3 – During the period of time following the **[\*CONFIDENTIAL\*]** from the Effective Date and through the remainder of the Term, the Mark-Up shall be adjusted to **[\*CONFIDENTIAL\*]** and the Price for the Products shall be calculated as the KeHE Cost multiplied by **[\*CONFIDENTIAL\*]**.
  - d. During Phase 1, payment terms shall be **[\*CONFIDENTIAL\*]**. During Phase 2 and 3 payment terms shall change to **[\*CONFIDENTIAL\*]**.
  - e. Cost for the Products may be changed from time to time with a minimum of thirty (30) days prior written notice. Notwithstanding the foregoing, for any Commodity driven price changes KeHE and SFM will mutually discuss the price change implementation date, which may be prior to the foregoing dates.
  - f. The Mark-Up and rebates set forth in this section are calculated and based on the Assumptions enumerated in Exhibit A. In the event one or more Assumptions are not being met or have changed in a material way such that they are no longer valid (e.g., material variations in projected purchase volume, the addition of stores, or material delivery frequency or drop size variations), KeHE shall provide SFM notice and the parties agree to meet within thirty (30) days of such notice to determine a course of action, which may include **[\*CONFIDENTIAL\*]**. The parties will work in good faith to determine a mutually agreeable course of action. If the parties are not able to agree on a course of action within sixty (60) days after such notice, then either party may terminate this Agreement, which termination shall be effective one hundred and eighty (180) days following delivery of notice of termination.
- 6) **PRIVATE LABEL**: This section will apply to all SFM branded Products, or any other Products which KeHE sells exclusively to SFM.
- a. Pricing. SFM will be billed at **[\*CONFIDENTIAL\*]**. Pricing shown in Section 5.

- b. Stocking of Private Label. KeHE agrees to stock all SFM private label Products carried by SFM and provide them to all SFM Stores. Continuing current practice, when SFM's movement on private label products in new regions is insufficient for direct delivery by the vendor to the KeHE distribution center, the cost plus pricing for those products will be adjusted to reflect the inter-facility transfer cost.
- c. Special Situations. The respective SFM department Category Managers will work in good faith with the KeHE private label team to proactively address "slow" turning skus of private label items in order to minimize the operational and financial impact on KeHE. "Slow" turns shall be defined as turns that do not meet reasonable category rate turn pursuant to industry standards. If the turns on a private label item (or line) are materially below the average for the overall product category, SFM and KeHE will work in good faith to resolve in a timely manner the slow turns on such items. KeHE shall not sell any SFM private label or control brand items to any other outlet without SFM's prior written approval.
- d. Code Date Management. The following shall be the private label management practices KeHE and SFM will continue to employ in order to manage private label inventory:
  - i. KeHE shall provide the respective SFM Category Managers a dedicated periodic inventory report showing expiration dates and time remaining for all private label Product inventories in each facility. This provides the opportunity for SFM and KeHE to manage close-coded private label items through special promotions and proactive distribution to SFM stores while the product is still saleable.
  - ii. The above procedures are aimed to minimize losses due to short-coded or past code private label inventory. In the event private label inventory is required to be discarded, SFM shall notify KeHE to remove the product from inventory and KeHE shall bill SFM or the corresponding private label manufacturer for the value of that inventory. To the extent the private label manufacturer will not accept such charges, **[\*CONFIDENTIAL\*]**.
  - iii. In the event KeHE fails to notify SFM of a private label's item short-code status at least 30 days prior to its expiration date, or at an earlier agreed- upon timeframe for items with shorter shelf-life, resulting in the private label item being discarded due to it reaching the end of its code date life, **[\*CONFIDENTIAL\*]**.
- e. Responsibilities: SFM will negotiate directly with the manufacturer for all new private label items. KeHE will provide the purchasing and distribution functions. The parties further agree to periodically review inflationary impact on private label Products.
- f. Discontinued Private Label: KeHE will purchase and stock all private label items in good faith to SFM's needs. **[\*CONFIDENTIAL\*]** The parties agree to work to define mutually agreeable terms for Products considered slow moving items. Existing, successful coordination will continue between SFM and KeHE buyers to minimize product loss.

7) **FUEL SURCHARGE (FSC):**

- a. During Phase 2 and Phase 3 of the Agreement, KeHE will provide a monthly report of the number of deliveries by store to SFM. SFM will be invoiced at [**\*CONFIDENTIAL\***] of the fuel surcharge specified in Schedule 3 (the "Fuel Surcharge Percentage") during the Term. Only one fuel surcharge may be applied per delivery of Product. If there is comingled inventory Products with the NB Agreement then the delivery expense will be allocated by department. SFM may audit the fuel surcharge billed at any time by referencing the average price per gallon of diesel fuel at: <http://tonto.eia.doe.gov/oog/info/wohdp/diesel.asp>.
- b. Both parties agree to review the Fuel Surcharge Percentage in good faith from time to time, but no earlier than after Phase 1, on an "open book" basis.

8) **PALLETS, TOTES, TRANSAFES:**

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

9) **SERVICE LEVEL ARRANGEMENT:**

- a. KeHE and SFM agree to the terms set forth in Exhibit "C" hereof regarding processing of credits, quality control and service levels.

10) **CONFIDENTIALITY:**

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

11) **COMPLIANCE WITH LAWS:**

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

12) **TERMINATION PROVISION:**

- a. Either party may terminate this Agreement immediately by providing written notice to the other party for a material breach of any obligations under the Agreement, and failure to cure such breach after [**\*CONFIDENTIAL\***] days' prior written notice of the breach.
- b. Either party may terminate this agreement if the other party becomes insolvent, admits in writing its insolvency, commences or has filed against it an bankruptcy, reorganization, liquidation or insolvency proceeding, or if any receiver, trustee, or liquidator is appointed to take possession of such party's assets.
- c. In addition to the Right of Termination for Cause set forth in Section 3 above, SFM may terminate this Agreement for cause if the quality of service provided by KeHE does not meet industry standards, and KeHE fails to substantially remedy the service within [**\*CONFIDENTIAL\***] days of written notice by SFM.
- d. Notwithstanding anything contained in this Agreement, the Right of Termination for Cause set forth in Section 3 hereof shall be a separate remedy from the termination provisions in this section.
- e. Following expiration or termination of this Agreement for any reason, SFM will purchase, or cause to be purchased by its incoming supplier, (a) all Products in KeHE's inventory that are in transit to SFM or for which KEHE has placed unconditional orders; (b) any SFM private label Products; (c) any Products sold exclusively to SFM; (d) any Products purchased in bulk at SFM's request; and/or (e) any Products otherwise purchased for SFM's account (provided such items are on SFM's authorized list of Products for purchase from KeHE and SFM shall only be responsible for inventory consistent with prior forecasting of the Products aligned with KeHE's turn rates at the time of the Termination.

13) **INDEMNIFICATION:**

KeHE agrees to indemnify, defend and hold harmless SFM, and its subsidiaries and affiliates, and their employees, officers, directors, members, shareholders, and agents (collectively the "SFM Indemnitees") from any and all third party claims, demands, threats, suits, proceedings, damages, liabilities or expenses (including reasonable attorney's fees) ("Claims") arising from or in connection with any allegation that any Product has directly or indirectly, in whole or in part: (i) given rise to any illness or injury to any person or animal, or any damage to property; (ii) has violated any applicable federal, state, local or

other law, rule or regulation, including without limitation any regulations of the Food and Drug Administration or the Consumer Product Safety Commission or other regulations enacted for the purposes of consumer protection; or (iii) is not merchantable or fit for its intended purpose; or (iv) is in any way defective or deficient in quality, labeling, packaging or manufacture. KeHE also agrees to indemnify, defend and hold harmless the SFM Indemnitees from any Claims arising out of the performance (or failure to perform) by KeHE of its obligations under this Agreement. The foregoing notwithstanding, KeHE shall not be liable for any Claims arising out of the negligence or willful misconduct of SFM or the SFM Indemnitees.

SFM agrees to indemnify, defend and hold harmless KeHE, its subsidiaries and affiliates, and their employees, officers, directors, members, shareholders, and agents (collectively the “KeHE Indemnitees”) from any and all Claims arising out of: (a) the performance (or failure to perform) by SFM of its obligations under this Agreement; (b) the negligence or willful misconduct of SFM, its agents or employees. The foregoing notwithstanding, SFM shall not be liable for any Claims arising out of the negligence or willful misconduct of KeHE or the KeHE Indemnitees.

14) **MISCELLANEOUS:**

- (a) Binding Effect: This Agreement, including its exhibits, supersedes all prior agreements between SFM and KeHE and constitutes the only agreement between SFM and KeHE, either oral or in writing, relating to the subject matter hereof, i.e., the supply/distribution of the Products. For the avoidance of doubt, this Agreement shall be separate and distinct from the NB Agreement, which will continue in full force and effect and the terms unaffected by this Agreement.
- (b) Force Majeure: “Force Majeure” events shall be events beyond the reasonable control of a party (and not through the fault or negligence of such party) that make timely performance of an obligation not possible, in which event the time for performance of the obligation affected by the event of Force Majeure shall be extended by the period of Force Majeure. Force Majeure events are those that are not reasonably foreseeable with the exercise of reasonable care, nor avoidable through the payment of nonmaterial additional sums. In the event of a Force Majeure, the party so affected shall give prompt written notice to the other party of the cause and shall take whatever reasonable steps are necessary to relieve the effect of such cause as rapidly as possible. The provisions of this section shall not apply to the financial obligations of either party to this Agreement that are unaffected by Force Majeure. For sake of clarity, an event caused by the gross negligence or willful misconduct of either party shall not be considered Force Majeure.
- (c) Governing Law; Forum and Jurisdiction; Waiver of Punitive and Similar Types of Damages: The relationship of the parties hereto and all claims arising out of or related to that relationship, including, but not limited to, the construction and interpretation of any written agreements, including this Agreement, shall be governed by the substantive laws of the State of Arizona (without regard to conflicts of law principles). The parties agree and consent to the jurisdiction of the state and federal courts located in Maricopa County, Arizona and acknowledge that such courts are proper and convenient forums for the resolution of any actions between the parties with respect to the subject matter of this Agreement, and agree

that, in such case, these courts shall be the sole and exclusive forums for the resolution of any actions between the parties with respect to the subject matter hereof. The parties hereby waive any right to a jury trial under any applicable law. The parties also waive any and all right to punitive, incidental or consequential damages, including but not limited to lost profits, except in the case an action is brought for breach of provisions relating to confidential information or as a result of gross negligence or willful misconduct on behalf of either party, as determined by final adjudication. The prevailing party in any action to enforce this Agreement shall be entitled to recover all related costs of the suit, including reasonable attorneys' fees and court costs.

- (d) Insurance. At all times during the Term, KeHE shall maintain, at its expense, occurrence based insurance coverage (the "Insurance Coverage") in the types and amounts as follows:
- Workers' Compensation and Employer's Liability insurance affording compensation benefits for all of its employees in an amount sufficient to meet all statutory requirements and employer's liability insurance with limits of **[\*CONFIDENTIAL\*]** for each accident or disease;
  - Commercial General Liability Insurance with a combined single limit of **[\*CONFIDENTIAL\*]** per occurrence and **[\*CONFIDENTIAL\*]** in the aggregate for personal injury, bodily injury (including wrongful death), and property damage liability inclusive of coverage for all premises and operations, broad form property damage,;
  - Automobile Liability Insurance with a combined single limit of **[\*CONFIDENTIAL\*]** per occurrence for injuries, including accidental death and property damage;
  - Products Liability Insurance with limits not less than **[\*CONFIDENTIAL\*]** per occurrence;
  - Umbrella or Excess Liability Insurance with limits not less than **[\*CONFIDENTIAL\*]** per occurrence that provides additional limits for employer's liability, commercial general liability, automobile liability and products liability insurance.
  - The Insurance Coverage will be from an insurance company classified by A M Best as a Class IV or larger with a Financial Strength Rating of at least A, A-. None of the Insurance Coverage amounts will be construed as a limitation on KeHE's potential liability. In connection with KeHE's execution of this Agreement, KeHE will provide SFM with certificates of insurance evidencing all of the referenced insurance policies, which will be renewed annually or as policy renewals occur. Except for Workers' Compensation and Employers Liability, the required insurance policies will, at KeHE's expense, name "SFM, LLC together with its subsidiaries and affiliates as additional insureds."
- (e) Amendment; Assignment: This Agreement may not be amended or modified except by a writing signed by an authorized officer of each party specifically referencing this Agreement and the intent to amend or modify.
- (f) Change of Control: The parties hereto agree that all of the provisions of this Agreement shall bind and inure to the benefit of the parties hereto and their respective heirs, legal representatives, successors and assigns, including but not

limited to, a Change of Control. A "Change of Control" means (A) any transaction or series of related transactions in which a party or group, acting in concert, acquires beneficial ownership of more than 50% of the equity interests in a party or its direct or indirect parent, or (B) a merger or consolidation of another entity with or into a party or its direct or indirect parent, with the effect that any third party becomes beneficial owner of more than 50% of the equity interests of a party or its direct or indirect parent.

- (g) Entire Agreement; Survival: All exhibits and schedules to this Agreement are incorporated by reference and are an integral part thereof. This Agreement (and any documents referred to herein) represents the entire agreement and understanding of the parties with respect to the matters set forth herein, and there are no representations, warranties or conditions or agreements (other than implementing invoices, purchase orders and the like necessary to implement this Agreement) not contained herein that constitute any part hereof or that are being relied upon by any party hereunder.
- (h) Severability: If any provision of this Agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the remaining provisions shall be enforced.
- (i) Notices: Unless otherwise stated, all notices given in connection with this Agreement will be in writing and will be deemed delivered at the time of personal delivery or 3 business days after being sent by facsimile (with a confirmation) or mailed by express, certified or registered mail, or sent by a recognized national or international courier, as appropriate (in all cases postage prepaid and return receipt requested). Notices shall be addressed to the parties at the addresses set forth below or to such other address as shall have been so notified to the other party in accordance with this section. Notices to KeHE shall be addressed to: Chief Commercial Officer, KeHE Distributors, LLC, 1245 E. Diehl Road, Suite 200, Naperville, IL 60563, with a copy to KeHE's Legal Department at the same address. Notices to SFM shall be addressed to: Chief Operational Officer, Sprouts Farmers Market, 5455 E High St., Suite 111, Phoenix, AZ 85054, with a copy not constituting notice to Sprouts' Legal Department at same address.
- (j) MPC and SFM: SFM certifies, represents and warrants to KeHE (1) that MPC and SFM, respectively, are not in default of any agreement between them, (2) that SFM has no claim against MPC for any penalties, fines, or breach of performance, related to the sale of products or any agreement between MPC and SFM, and (3) that MPC has not failed to perform any obligation owed to SFM. SFM acknowledges that KeHE's entering into this Agreement and acquiring substantially all of the assets of MPC is contingent upon receiving SFM's representations and warranties stated in this section and SFM agrees that KeHE may rely upon the same, and that it is made for the benefit of KeHE, its successors and assigns. SFM agrees that KeHE shall not be responsible for any charges or liabilities from MPC related to SFM's audit of MPC charges prior to the Effective Date.

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

Signatures: next page

Page 13 of 14

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

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

SFM, LLC dba Sprouts Farmers Market

KeHE Distributors, LLC

By: /s/ Amin Maredia  
Signature

/s/ Brandon Barnholt  
Signature

Amin Maredia  
Print Name

Brandon Barnholt  
Print Name

2/5/16  
Date

2/11/16  
Date

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

**List of Exhibits and Schedules**

Exhibit "A" – Assumptions

Exhibit "B" – KeHE Special Services

Exhibit "C" – Credits, Quality Control and Service Levels

Exhibit "C-1" – MPC Credit Policy

Schedule 1 – **[\*CONFIDENTIAL\*]** Products

Schedule 2 – Phase 1 Products

Schedule 3 – Fuel Surcharge Schedule

## Exhibit "A"

### Assumptions\*\*

1. **Volume** – Annual volume is expected to be approximately **[\*CONFIDENTIAL\*]** in net purchases inclusive of the DPI business.
2. **Transportation** - Product is delivered direct to each retail location. Select locations may be arranged for customer pick-up and/or crossdock, upon mutual agreement. Fuel Surcharge will apply to delivered orders per Schedule 3.
3. **Order Frequency** – Initially, all locations may place up to two (2) orders per week and up to three (3) orders per week during first (4) four weeks of a store opening. Additionally, certain locations receive up to three (3) orders per week on an ongoing basis **[\*CONFIDENTIAL\*]**. At a minimum, every six (6) months, individual store performance will be reviewed and order frequency may be optimized in accordance with average weekly volume.
4. **General Assumptions**
  - a. Orders must meet a minimum value of **[\*CONFIDENTIAL\*]** to be processed and shipped.
  - b. Sprouts Private Label and Exclusive Products cannot be sold or distributed by KeHE (Sprouts "Exclusive Products" are products formulated/designed specifically for SFM)
  - c. Initial Expected Average Order Size (in KeHE Cost) = **[\*CONFIDENTIAL\*]**
    - i. With Dpi volume this number would be approx **[\*CONFIDENTIAL\*]** (this is the average of all volume divided by number of total deliveries)
  - d. Initial Expected Average Pick Value (in KeHE Cost) = **[\*CONFIDENTIAL\*]**
    - i. Expected Average Pick Value is based on an approx. split of **[\*CONFIDENTIAL\*]** (Percentage of product selected in Full Case/Split Case).
  - e. Temperature Profile = **[\*CONFIDENTIAL\*]** (Percentage Ref/Frz)
  - f. Pricing is based on an approx. store count of 220 as well as other assumptions such as but not limited to those related to transportation, services, and volume.
  - g. KeHE expects a healthy and productive SKU mix/APL. KeHE expects that Private Label/Control Brand products will not exceed **[\*CONFIDENTIAL\*]** of total purchases as measured in KeHE Cost. In the event that the SKU mix becomes further influenced by these items or those with sub-optimal SKU productivity, further discussion and **[\*CONFIDENTIAL\*]** upon mutual agreement of the parties, may be required. At the time of the agreement the average annual volume per-SKU, per-DC (SKU Productivity) is approx. **[\*CONFIDENTIAL\*]**.
  - h. Bill-To-Ship-To (BTST) purchases are excluded from calculations used to determine annual purchases, order frequency, or any other metrics. Any product sold on a BTST basis will be priced at a margin of **[\*CONFIDENTIAL\*]** with payment terms consistent with non-BTST purchases.

\*\* Within sixty (60) days following the end of Phase 1 (as defined in the Agreement), the parties agree to confer on the accuracy of the Assumptions and adjust to accurately reflect the business relationship.

Exhibit "B"

**KeHE Special Services**

**President of Monterrey Provisions**

The President plays an integral role in the Sprouts-Monterrey relationship. He/she is the primary contact for senior management at Sprouts and leads the team at Monterrey team that supports Sprouts. The President will remain the primary contact and continue to support to the Sprouts team at the same level.

**Director of Sales and Key Account Rep to Sprouts Farmers Market, [\*CONFIDENTIAL\*]**

Scottsdale, AZ

Key Account Rep to Sprouts Farmers Market, based in Phoenix.

Main responsibilities:

- Hosts weekly and monthly meeting with each category manager
- Presents new items
- Works with vendors, brokers and Monterrey purchasing team to set up new items and place POs
- Works with Sprouts category managers on weekly and monthly ads and collects promotions from vendors
- Manages the Sprouts Support fund
- Arranges merchandiser's schedules at Grand Opening and remodeled stores.
- Communicates with Sprouts stores and Sprouts Support Team daily
- Launches new items and programs with stores
- Manages Sprouts inventory to reduce spoils and shortages
- Works with Support Team to arrange Ad and holiday roll outs.
- Manages the Sprouts online ordering system
- Creates and maintains Sprouts order guides
- Attends Food Shows such as IDDBA and Fancy Food Show with Sprouts Team
- Managing Sprouts Pricing and price changes

**Key Account Support Supervisor, [\*CONFIDENTIAL\*]**

Manages the Key Account Support and Sprouts Customer Service Center. In charge of the day to day activities relating to Sprouts. This includes store orders, deliveries, customer service maintenance and overall customer service. Works with team to ensure customer satisfaction and problem resolution in a timely manner. He also works on special Sprouts projects including price files, new item paperwork, new project roll outs and price changes. Also works very closely with Transportation, Purchasing, IT and Operations Departments as it relates to Sprouts and providing the best service.

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

**National Merchandiser/KAR, [\*CONFIDENTIAL\*], Phoenix, AZ**

Merchandiser for the Eastern United States. He is based in Phoenix, AZ and travels two to three weeks per month to attend grand openings, remodels, merchandising and conduct trainings with Sprouts employees. Provides support at the Sprouts Support Office. Is the primary Monterrey representative for the Sprouts Meat Department.

**National Merchandiser, [\*CONFIDENTIAL\*]**

Western Merchandiser for Sprouts. He travels to grand openings and new store sets. Helps merchandise the local Sprouts in California, including training, remodels, holiday sets, sampling and general merchandising, and also works on the Sprouts Ad sheet.

**Customer Service, [\*CONFIDENTIAL\*]**

Works on the daily call sheet, enters weekly plus outs for Bakery and Deli ads for all stores, enters fresh meat orders for Niman Ranch, handles Sprouts credits and enters manual bill backs into the online system.

**Key Account Rep, [\*CONFIDENTIAL\*]**

Handles the Sprouts Dairy and Grocery department. Meets with each department category manager once per month presenting new items, reviewing current projects, local sets, vendor lines and new store openings. Works with the Monterrey purchasing team to set up new items, maintain current lines and set up monthly promotions. Also works with vendors and brokers on free fills for new set schematics for each Sprouts region.

**Sprouts / Monterrey Support Fund**

Monterrey Provision Co., Inc. (Monterrey) manages the "Sprouts / Monterrey Support Fund." The fund is for the exclusive benefit of Sprouts and is exclusive of any other pricing and rebate programs that exist between our companies.

Monterrey deducts between **[\*CONFIDENTIAL\*]** and **[\*CONFIDENTIAL\*]** of the net value of sales to Sprouts on participating vendors' products. As of December 4, 2015, **[\*CONFIDENTIAL\*]**. The fund generates, on average, **[\*CONFIDENTIAL\*]**. KeHE agrees to pass through the funds as a conduit only and shall not be responsible for any amounts related to the fund except to the extent collected from vendors. Sprouts agrees to be responsible for any disputes with vendors related to the fund. KeHE will monitor and provide a status of support funds by item on a monthly basis for Sprouts management purposes.

The fund is used to support Sprouts' merchandising initiatives, promotions and program development.

## Exhibit "C"

### CREDITS; QUALITY CONTROL; SERVICE LEVELS

#### I. CREDITS:

- A. Phase 1: During Phase 1, as defined in Section 5, KeHE's credit practices will be consistent with the practices of MPC as described in Exhibit C-1 below, including writing credits for items that are damaged at the time of delivery, mispicks, shorts, and out-of-code at the time of delivery. Additionally, SFM will receive a credit for any frozen raw dough or raw batters (i.e., bread, pastries, muffins, pies) determined in good faith by SFM within 48hrs of delivery to have been temperature abused prior to receiving the Product and within 24hrs of delivery for all other Products ("Credits for Temperature Abuse") (Credits for Temperature Abuse shall subsist for the Term of the Agreement). No credits will be given for in-store issues, such as spoilage or in-store damages with the exception of Products "guaranteed" by the manufacturer, i.e., Products that are returned to manufacturers for credits regardless of reason for return, and provided KeHE actually receives credit for such Products from the manufacturer.
- B. Credit Allowance: After Phase 1, as defined in Section 5 of the Agreement, in order to eliminate the resources and administrative cost associated with SFM stores calling in and managing individual item credits, and KeHE researching and processing them, KeHE and SFM shall implement a credit allowance for the Products in the form of **[\*CONFIDENTIAL\*]** (the "Credit Allowance"), which will be consistent with any Credit Allowance agreed upon under the NB Agreement, including any agreed upon audits. This allowance is established to compensate stores for routine occurrences of mis-picked items, item shortages and damaged products (collectively "Shortages"). SFM and KeHE agree to periodically review the Credit Allowance and mutually agree upon any necessary changes to the Credit Allowance based on actual credits from audits at mutually agreeable intervals by department.
- C. Exceptions: Notwithstanding the Credit Allowance above, a credit request may be called into KeHE's Service Center when the following occurs ("Exception" or "Exceptions"):
- a. A shipment involving excessive shortages or damaged product involving the following:
    - i. **[\*CONFIDENTIAL\*]** of Products on a single delivery is shorted or damaged on the delivery.
    - ii. Entire pallet(s) or tote(s) are missing from the delivery.
  - b. Product is shipped out-of-code (private label and control brand items allocated to the stores by SFM's support office do not apply). Must be called in within 24 hours of delivery.
  - c. Manufacturer product recalls.
  - d. Infested product. Must be called in within 24 hours of delivery.
  - e. Highly perishable products (yogurts, eggs, kefir, sour cream, cottage cheese, fluid milk) expiring within 7 days of invoice date upon delivery. Must be called in within 24 hours of delivery. Private label items are not eligible for call in.

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

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

No credits outside of the Exceptions will be accepted. SFM stores will NOT be permitted to submit credits for Products that are damaged or go out of code post-delivery, except for (i) Credits for Temperature Abuse as provided above, and (ii) Product that is determined as substandard from the manufacturer (at any time after delivery) and where credit will need to be processed by KeHE and billed back to the manufacturer.

Credits outside of the Exceptions will be mutually reviewed on a “by occurrence basis” and resolved in timely and in good faith by both parties.

## **II. SERVICE LEVELS:**

### **A. Service and Support.**

- a. KeHE shall provide Products consistent with industry standards in the volumes requested by SFM subject to all terms and conditions of this Agreement.
- b. MPC currently provides the support services outlined in Exhibit A to this Agreement, and KeHE will continue to adjust/improve its services to support SFM in the future.
- c. During Phase 1, KeHE will continue to provide deliveries to SFM stores consistent with the prior practices of MPC. During Phase 2, the parties will work in good faith to optimize delivery levels in order to provide efficiencies with KeHE's current delivery practices. Delivery frequency is currently, and will be in the future, adjusted up for high volume stores based on purchase volume.
- d. KeHE currently provides a wide range of reports to SFM to support the SFM category management team and business needs, and will continue to work with SFM with reports on as needed basis.

## Exhibit C-1

### MPC Credit Policy

# Monterrey | The Natural Choice Return & Credit Policy

## **CREDITS & ADJUSTMENTS ON THE DAY OF DELIVERY**

Your driver is authorized to issue credits for missing (N.O.T.), mis-picked, short coded or damaged goods at the time of delivery. Customers are responsible for carefully checking and noting any discrepancy prior to signing the delivery paperwork. If a credit is due, your driver will issue an invoice adjustment receipt for your records.

## **RETURNS FOR FROZEN**

In compliance with HAACP, to protect the integrity of our products, and for the safety of our customers, returns for frozen product can only be processed by the driver at the time of delivery.

## **RETURN GUIDELINES**

All claims must have prior approval before returning to the driver. Our Team may determine because of the condition of the product that the contents may be discarded; however you may be requested to return the UPC code or lids. All products must be returned with all the pieces in the original box. Product that is deemed a good return but not returned in saleable condition will be charged back to your account. Frozen thaw and sell products are eligible for return under special circumstances to include new store openings or special market promotions if needed.

---

## **REQUESTING CREDITS AFTER YOUR DELIVERY**

If a mis-pick, short coded, or hidden damage is discovered after your delivery driver has left, you may still request credit for these items. All credit and return requests must be made within **48 Hours** of the delivery date. Anything submitted after this time frame will be reviewed on a case by case bases.

A Credit Request is submitted on line at [www.monprov.com/sprouts.php](http://www.monprov.com/sprouts.php). Using the customer online portal the information required is Invoice Number, Item Number, and

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

rationale for credit request. After your credit has been reviewed by our team, we will post the credit against the original invoice amount.

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

## HOW TO REQUEST A CREDIT AFTER YOUR DELIVERY:

Please use one of the following methods to request a credit:

- **ONLINE:** Log on to [www.monprov.com/sprouts.php](http://www.monprov.com/sprouts.php) and follow the form data for credit request.

If you would like to speak with one of our team members, we are available Monday thru Friday from 8am to 4pm PST at 619-294-2222.

When calling, please leave the following

information: Your Name  
Customer Number  
Phone Number  
Best time to reach you.

Someone from our team will call you back to begin the credit process.

## ACCEPTABLE CREDIT REASONS

All credit and return requests will be reviewed by our team and must meet one of the following criteria:

- **Mis-picked Items:** Received a different product in place of product ordered (PICKING label is correct, wrong product). Please report the UPC number of the item received, as well as a picture of the picking label when submitting your claim.
- **Quality:** Item is unusable due to manufacturer's defect, such as no safety seal, poor product integrity; Please report the expiration date or lot number of the item received.
- **Damaged Product:** Product arrived damaged. Please submit pictures of the damaged product, along with the picking label. Product that arrives out of temp is considered a damaged product.
- **Short Coded Products:**

Retail Packaged - 10 days with guaranteed credit

Bulk > 30 days - customer will be asked to sell product through code and apply for credit on unsold items to avoid waste. Credit guaranteed on on these items.

Freezer Items cannot be returned, to ensure product quality and integrity and safety for all our customers , we do not accept returns of frozen product.

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

## **CREDITS & ADJUSTMENTS ON DAY OF DELIVERY**

In some instances orders may be delivered by a common carrier hired by Monterrey. Common Carriers are responsible for transporting your order from our warehouse to your receiving dock.

For the locations serviced via common carrier, we do not have the option of performing an electronic check in at the time of delivery. Please revert to "Requesting Credits After Your Delivery" for credit requests.

## **RETURN GUIDELINES**

Locations that are not listed as remote will schedule a pickup with Monterrey's credit team. A pick up slip will be issued and handed to the driver. For destinations listed as "remote destinations" above, no pick up slips will be issued. Monterrey credit team may sell at a discount or product must be donated to local shelter or discarded.

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

Schedule 1

**[\*CONFIDENTIAL\*] Products**

**[\*CONFIDENTIAL\*]**

**[30 PAGES HAVE BEEN OMITTED AND FILED SEPARATELY WITH THE SEC.]**

Page 11 of 42

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

Schedule 2

Phase 1 Products

**[\*CONFIDENTIAL\*]**

**[42 PAGES HAVE BEEN OMITTED AND FILED SEPARATELY WITH THE SEC.]**

Page 41 of 42

Schedule 3

**Fuel Surcharge Schedule**

Price Per Gallon*	FUEL SURCHARGE (FSC)
\$1.88 and below	[*CONFIDENTIAL*]
\$2.13	[*CONFIDENTIAL*]
\$2.25	[*CONFIDENTIAL*]
\$2.38	[*CONFIDENTIAL*]
\$2.50	[*CONFIDENTIAL*]
\$2.63	[*CONFIDENTIAL*]
\$2.75	[*CONFIDENTIAL*]
\$2.88	[*CONFIDENTIAL*]
\$3.00	[*CONFIDENTIAL*]
\$3.13	[*CONFIDENTIAL*]
\$3.25	[*CONFIDENTIAL*]
\$3.38	[*CONFIDENTIAL*]
\$3.50	[*CONFIDENTIAL*]
\$3.63	[*CONFIDENTIAL*]
\$3.75	[*CONFIDENTIAL*]
\$3.88	[*CONFIDENTIAL*]
\$4.00	[*CONFIDENTIAL*]
\$4.13	[*CONFIDENTIAL*]
\$4.25	[*CONFIDENTIAL*]
\$4.38	[*CONFIDENTIAL*]
\$4.50	[*CONFIDENTIAL*]
\$4.63 and above	[*CONFIDENTIAL*]

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

[\(Back To Top\)](#)

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

**Exhibit 31.1**

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

I, Amin N. Maredia, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sprouts Farmers Market, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed

under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2016

*/s/ Amin N. Maredia*

Amin N. Maredia

Chief Executive Officer

(Principal Executive Officer)

[\(Back To Top\)](#)

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

**Exhibit 31.2**

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

I, Bradley S. Lukow, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sprouts Farmers Market, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2016

*/s/ Bradley S. Lukow*

---

Bradley S. Lukow  
Chief Financial Officer  
(Principal Financial Officer)

[\(Back To Top\)](#)

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

**Exhibit 32.1**

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

In connection with the quarterly report of Sprouts Farmers Market, Inc. (the "Company"), on Form 10-Q for the quarterly period ended July 3, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Amin N. Maredia, Chief Executive Officer of the Company, certify, based on my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 4, 2016

*/s/ Amin N. Maredia*

---

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

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

[\(Back To Top\)](#)

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

**Exhibit 32.2**

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

In connection with the quarterly report of Sprouts Farmers Market, Inc. (the "Company"), on Form 10-Q for the quarterly period ended July 3, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bradley S. Lukow, Chief Financial Officer of the Company, certify, based on my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 4, 2016

*/s/ Bradley S. Lukow*

---

Bradley S. Lukow

Chief Financial Officer

(Principal Financial Officer)

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

[\(Back To Top\)](#)