

Sprouts Farmers Market, Inc.  
Form 10-Q  
May 05, 2016

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 April 3, 2016

Commission File Number: 001-36029

Sprouts Farmers Market, Inc.

(Exact name of registrant as specified in its charter)

Delaware 32-0331600  
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) 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

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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 May 3, 2016, there were outstanding 150,742,588 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 APRIL 3, 2016

TABLE OF CONTENTS

|  | Page |
|--|------|
| <u>PART I - FINANCIAL INFORMATION</u>  |      |
| <u>Item 1. Financial Statements.</u>   | 1    |
| <u>Consolidated Balance Sheets as of April 3, 2016 and January 3, 2016 (unaudited)</u>   | 1    |
| <u>Consolidated Statements of Operations for the thirteen weeks ended April 3, 2016 and March 29, 2015 (unaudited)</u>                           | 2    |
| <u>Consolidated Statements of Stockholders' Equity for the thirteen weeks ended April 3, 2016 and the year ended January 3, 2016 (unaudited)</u> | 3    |
| <u>Consolidated Statements of Cash Flows for the thirteen weeks ended April 3, 2016 and March 29, 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>   | 15   |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u>   | 23   |
| <u>Item 4. Controls and Procedures.</u>  | 24   |
| <u>PART II - OTHER INFORMATION</u>   |      |
| <u>Item 1. Legal Proceedings.</u>  | 25   |
| <u>Item 1A. Risk Factors.</u>  | 25   |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.</u>  | 25   |
| <u>Item 6. Exhibits.</u>   | 26   |
| <u>Signatures</u>  | 27   |

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## 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,” “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,” “we,” “us” and “our” refer to Sprouts Farmers Market, Inc. and, where appropriate, its subsidiaries.

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## 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)

|  | April 3,     | January 3,   |
|--|--------------|--------------|
|  | 2016         | 2016         |
| <b>ASSETS</b>  |              |              |
| Current assets:  |              |              |
| Cash and cash equivalents  | \$ 145,650   | \$ 136,069   |
| Accounts receivable, net   | 14,953       | 20,424       |
| Inventories  | 172,552      | 165,434      |
| Prepaid expenses and other current assets                          | 18,741       | 23,288       |
| Total current assets   | 351,896      | 345,215      |
| Property and equipment, net of accumulated depreciation            | 507,398      | 494,067      |
| Intangible assets, net of accumulated amortization                 | 198,300      | 198,601      |
| Goodwill   | 368,078      | 368,078      |
| Other assets   | 23,764       | 19,003       |
| Deferred income tax asset  | —            | 1,400        |
| Total assets   | \$ 1,449,436 | \$ 1,426,364 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                        |              |              |
| Current liabilities:   |              |              |
| Accounts payable   | \$ 157,000   | \$ 134,480   |
| Accrued salaries and benefits                                      | 25,650       | 30,717       |
| Other accrued liabilities  | 44,298       | 50,253       |
| Income tax payable   | 11,222       | —            |
| Current portion of capital and financing lease obligations         | 7,072        | 14,972       |
| Total current liabilities  | 245,242      | 230,422      |
| Long-term capital and financing lease obligations                  | 113,942      | 115,500      |
| Long-term debt   | 160,000      | 160,000      |
| Other long-term liabilities  | 106,199      | 97,450       |
| Deferred income tax liability                                      | 6,010        | —            |
| Total liabilities  | 631,393      | 603,372      |
| 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,    | 151          | 153          |

150,731,088 and 152,577,884 shares issued and outstanding,

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April 3, 2016 and January 3, 2016, respectively

|  |             |             |
|--|-------------|-------------|
| Additional paid-in capital                 | 585,545     | 577,393     |
| Retained earnings                          | 232,347     | 245,446     |
| Total stockholders' equity                 | 818,043     | 822,992     |
| Total liabilities and stockholders' equity | \$1,449,436 | \$1,426,364 |

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<br>Ended |           |
|--|-------------------------|-----------|
|  | April 3,                | March 29, |
|  | 2016                    | 2015      |
| Net sales                                    | \$993,241               | \$857,506 |
| Cost of sales, buying and occupancy          | 686,728                 | 599,713   |
| Gross profit                                 | 306,513                 | 257,793   |
| Direct store expenses                        | 193,778                 | 163,190   |
| Selling, general and administrative expenses | 30,896                  | 24,027    |
| Store pre-opening costs                      | 3,966                   | 2,773     |
| Store closure and exit costs                 | 37                      | 1,229     |
| Income from operations                       | 77,836                  | 66,574    |
| Interest expense                             | (3,601 )                | (5,868 )  |
| Other income                                 | 101                     | 62        |
| Income before income taxes                   | 74,336                  | 60,768    |
| Income tax provision                         | (28,129 )               | (23,301 ) |
| Net income                                   | \$46,207                | \$37,467  |
| Net income per share:                        |                         |           |
| Basic  | \$0.31                  | \$0.25    |
| Diluted                                      | \$0.30                  | \$0.24    |
| Weighted average shares outstanding:         |                         |           |
| Basic  | 150,723                 | 152,235   |
| Diluted                                      | 153,144                 | 155,482   |

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)

|  |              | Common | Additional<br>Paid In | Retained   | Total<br>Stockholders' |
|--|--------------|--------|-----------------------|------------|------------------------|
|  | Shares       | Stock  | Capital               | Earnings   | Equity                 |
| Balances at December 28, 2014                | 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<br>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                  |
| Balances at January 3, 2016                  | 152,577,884  | \$ 153 | \$ 577,393            | \$ 245,446 | \$ 822,992             |
| Net income                                   | —            | —      | —                     | 46,207     | 46,207                 |
| Issuance of shares under option plans        | 584,925      | -      | 1,933                 | —          | 1,933                  |
| Repurchase and retirement of common<br>stock | (2,431,721 ) | (2 )   | -                     | (59,306 )  | (59,308 )              |
| Excess tax benefit for exercise of options   | —            | —      | 3,563                 | —          | 3,563                  |
| Equity-based compensation                    | —            | —      | 2,656                 | —          | 2,656                  |
| Balances at April 3, 2016                    | 150,731,088  | \$ 151 | \$ 585,545            | \$ 232,347 | \$ 818,043             |

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)

|   | Thirteen Weeks Ended<br>April 3,<br>2016 | March 29,<br>2015 |
|---|--|-------------------|
| Cash flows from operating activities  |  |                   |
| Net income  | \$ 46,207                                | \$ 37,467         |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |                   |
| Depreciation and amortization expense   | 18,832                                   | 15,853            |
| Accretion of asset retirement obligation and closed facility reserve              | 80                                       | 79                |
| Amortization of financing fees and debt issuance costs                            | 116                                      | 339               |
| (Gain)/Loss on disposal of property and equipment                                 | (117 )                                   | 272               |
| Equity-based compensation   | 2,656                                    | 1,142             |
| Deferred income taxes   | 7,410                                    | 1,657             |
| Changes in operating assets and liabilities:                                      |  |                   |
| Accounts receivable   | 5,638                                    | (11,895 )         |
| Inventories   | (7,119 )                                 | (5,960 )          |
| Prepaid expenses and other current assets   | 4,547                                    | (4,098 )          |
| Other assets  | (4,876 )                                 | (6,307 )          |
| Accounts payable  | 15,578                                   | 29,474            |
|   | (5,068 )                                 | (5,055 )          |

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|  |            |            |
|--|------------|------------|
| Accrued salaries and benefits                        |            |            |
| Other accrued liabilities and income taxes payable   | 5,105      | 1,962      |
| Other long-term liabilities                          | 8,958      | 13,154     |
| Net cash provided by operating activities            | 97,947     | 68,084     |
| Cash flows from investing activities                 |            |            |
| Purchases of property and equipment                  | (34,000 )  | (33,755 )  |
| Proceeds from sale of property and equipment         | 662        | —          |
| Purchase of leasehold interests                      | (138 )     | —          |
| Net cash used in investing activities                | (33,476 )  | (33,755 )  |
| Cash flows from financing activities                 |            |            |
| Payments on term loan                                | —          | (1,750 )   |
| Payments on capital lease obligations                | (173 )     | (161 )     |
| Payments on financing lease obligations              | (905 )     | (836 )     |
| Repurchase of common stock                           | (59,308 )  | —          |
| Excess tax benefit for exercise of stock options     | 3,563      | 12,199     |
| Proceeds from the exercise of stock options          | 1,933      | 3,425      |
| Net cash (used in) provided by financing activities  | (54,890 )  | 12,877     |
| Net increase in cash and cash equivalents            | 9,581      | 47,206     |
| Cash and cash equivalents at beginning of the period | 136,069    | 130,513    |
| Cash and cash equivalents at the                     | \$ 145,650 | \$ 177,719 |

end of the period

Supplemental  
disclosure of cash  
flow information

|                        |    |       |    |       |
|------------------------|----|-------|----|-------|
| Cash paid for interest | \$ | 3,716 | \$ | 5,564 |
|------------------------|----|-------|----|-------|

|                            |  |   |  |     |
|----------------------------|--|---|--|-----|
| Cash paid for income taxes |  | — |  | 249 |
|----------------------------|--|---|--|-----|

Supplemental  
disclosure of  
non-cash investing  
and financing

activities

|  |    |        |    |        |
|--|----|--------|----|--------|
| Property and equipment in accounts payable | \$ | 23,137 | \$ | 21,147 |
|--|----|--------|----|--------|

|   |  |       |  |   |
|---|--|-------|--|---|
| Property acquired through capital and financing lease obligations |  | 1,744 |  | — |
|---|--|-------|--|---|

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

Sprouts Farmers Market, Inc., a Delaware corporation, through its subsidiaries, operates as a healthy grocery store that offers fresh, natural and organic food that includes fresh produce, bulk foods, vitamins and supplements, grocery, meat and seafood, bakery, deli, dairy, frozen foods, body care and natural household items catering to consumers' growing interest in eating and living healthier. The "Company" is used to refer collectively to Sprouts Farmers Market, Inc. and 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 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. 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 fourth quarter of fiscal 2015 included 14 weeks.

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 thirteen weeks ended April 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 require 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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

effective 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 thirteen weeks ended April 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 April 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    |            |
|----------------------------|----------|------------|
|                            | April 3, | January 3, |
|                            | 2016     | 2016       |
| Vendor                     | \$9,783  | \$11,649   |
| Receivables from landlords | 1,552    | 4,143      |
| Other                      | 3,618    | 4,632      |
| Total                      | \$14,953 | \$20,424   |

The Company had recorded allowances for certain vendor receivables of \$0.1 million and \$0.1 million at April 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    |            |
|-----------------|----------|------------|
|                 | April 3, | January 3, |
|                 | 2016     | 2016       |
| Accrued payroll | \$10,470 | \$10,988   |
| Vacation        | 10,153   | 8,916      |
| Bonus           | 4,574    | 9,728      |
| Other           | 453      | 1,085      |
| Total           | \$25,650 | \$30,717   |

## 6. Long-Term Debt

A summary of long-term debt is as follows:

| Facility                                 | Maturity       | Interest Rate | As of     |            |
|--|----------------|---------------|-----------|------------|
|  |                |               | April 3,  | January 3, |
|  |                |               | 2016      | 2016       |
| Senior secured debt                      |                |               |           |            |
| \$450.0 million Credit Facility          | April 17, 2020 | Variable      | \$160,000 | \$160,000  |
| Total debt                               |                |               | 160,000   | 160,000    |
| Long-term debt                           |                |               | \$160,000 | \$160,000  |
| 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 existing \$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 April 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 April 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 April 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 thirteen weeks ended April 3, 2016 and fiscal year ended January 3, 2016:

|                   | April<br>3, | January<br>3, |
|-------------------|-------------|---------------|
|                   | 2016        | 2016          |
| Beginning balance | \$2,017     | \$1,785       |
| Additions         | —           | 1,144         |
| Usage             | (319 )      | (1,332)       |
| Adjustments       | (24 )       | 420           |
| Ending balance    | \$1,674     | \$2,017       |

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 April 3, 2016 and March 29, 2015 was 37.8% and 38.3%, respectively. The primary reasons for the decrease in the effective tax rate were an increase in the enhanced deduction for charitable donations of food inventory and a decrease 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 \$3.6 million for the thirteen weeks ended April 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 April 3, 2016 and March 29, 2015, purchases from this supplier were \$2.5 million

and \$2.3 million, respectively. At April 3, 2016 and March 29, 2015, the Company had recorded accounts payable due to this supplier of \$0.8 million and \$0.7 million, respectively.

Another member of the Company's board of directors purchased stock in a technology supplier to the Company in January 2015 and provided a loan to this company in May 2015. During the thirteen weeks ended April 3, 2016 and March 29, 2015, purchases from this supplier were \$1.2 million and \$1.3 million, respectively. At both April 3, 2016 and March 29, 2015, the Company had recorded accounts payable due to this supplier of \$0.2 million.

This board member also provided a convertible loan to a technology supplier to the Company in September 2015. During the thirteen weeks ended April 3, 2016 and March 29, 2015, purchases from this supplier were \$0.1 million and \$0.1 million, respectively. At both April 3, 2016 and March 29, 2015, the Company had recorded accounts payable due to this supplier of \$0.1 million.

#### 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.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Shareholder Class Action

On March 4, 2016, a complaint was filed in the Superior Court for the State of Arizona 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. 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 common stock share repurchase program. 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 April 3, 2016, the Company repurchased 2,431,721 shares of common stock for \$59.3 million and subsequently retired such shares. The Company did not repurchase any shares during the thirteen weeks ended March 29, 2015. As of April 3, 2016, there is \$65 million available under the \$150 million common stock share repurchase program.

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").

## SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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<br>Ended |                   |
|--|-------------------------|-------------------|
|  | April 3,<br>2016        | March 29,<br>2015 |
| <b>Basic net income per share:</b>             |                         |                   |
| Net income                                     | \$46,207                | \$37,467          |
| Weighted average shares outstanding            | 150,723                 | 152,235           |
| Basic net income per share                     | \$0.31                  | \$0.25            |
| <b>Diluted net income per share:</b>           |                         |                   |
| Net income                                     | \$46,207                | \$37,467          |
| Weighted average shares outstanding            | 150,723                 | 152,235           |
| Dilutive effect of equity-based awards:        |                         |                   |
| Assumed exercise of options to purchase shares | 2,350                   | 3,216             |
| RSUs   | 49                      | 31                |
| PSAs   | 22                      | —                 |
| Weighted average shares and equivalent         |                         |                   |
| shares outstanding                             | 153,144                 | 155,482           |
| Diluted net income per share                   | \$0.30                  | \$0.24            |

For the thirteen weeks ended April 3, 2016, the computation of diluted net income per share does not include 0.9 million options, 0.2 million RSUs, and 0.1 million PSAs as those awards would have been antidilutive or were unvested performance awards. For the thirteen weeks ended March 29, 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.

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 April 3, 2016, there were 3,760,969 stock awards outstanding under the 2013 Incentive Plan.

#### 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 April 3, 2016, there were 3,917,644 options outstanding under the 2011 Option Plan.

## SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

## Awards Granted

During the thirteen weeks ended April 3, 2016, the Company granted the following stock-based compensation awards:

| Grant Date                             | Stock   |         |         |
|--|---------|---------|---------|
|  | Options | RSUs    | PSAs    |
| March 4, 2016                          | 318,156 | 213,767 | 92,942  |
| Weighted-average grant date fair value | \$8.59  | \$28.21 | \$28.21 |
| Weighted-average exercise price        | \$28.21 | —       | —       |

## 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. During the thirteen weeks ended April 3, 2016, 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 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.



## SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

## Equity-based Compensation Expense

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

|  | Thirteen Weeks<br>Ended |                   |
|--|-------------------------|-------------------|
|  | April 3,<br>2016        | March 29,<br>2015 |
| Cost of sales, buying and occupancy                      | \$218                   | \$ 101            |
| Direct store expenses                                    | 317                     | 183               |
| Selling, general and administrative expenses             | 2,121                   | 858               |
| Equity-based compensation expense before income<br>taxes | 2,656                   | 1,142             |
| Income tax benefit                                       | (1,009)                 | (446)             |
| Net equity-based compensation expense                    | \$1,647                 | \$ 696            |

As of April 3, 2016 and January 3, 2016, there were approximately 7.2 million and 7.4 million options outstanding, of which 2.2 million and 2.1 million were unvested options, respectively.

As of April 3, 2016 and January 3, 2016, there were approximately 0.3 million and 0.1 million unvested RSUs outstanding, respectively.

As of April 3, 2016 and January 3, 2016, there were approximately 0.2 million and 0.1 million unvested PSAs outstanding, respectively.

As of April 3, 2016 total unrecognized compensation expense related to outstanding options was \$14.2 million which, if the applicable service conditions are fully met, is expected to be recognized over the next 2.2 years on a weighted-average basis.

As of April 3, 2016, total unrecognized compensation expense related to outstanding RSUs was \$7.9 million which, if the service conditions are fully met, is expected to be recognized over the next 2.2 years on a weighted-average basis.

As of April 3, 2016, total unrecognized compensation expense related to outstanding PSAs for which the performance criteria has been achieved was \$1.4 million, which is expected to be recognized over the next 1.4 years on a weighted-average basis.

As of April 3, 2016, total unrecognized compensation expense related to outstanding PSAs for which the performance period is in progress was \$2.6 million which, if the performance conditions are fully met, is expected to be recognized

over the next 2.9 years on a weighted-average basis. If performance conditions are not met, no expense will be recorded.

During the thirteen weeks ended April 3, 2016 and March 29, 2015, the Company received \$1.9 million and \$3.4 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 228 stores in 13 states as of April 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

15

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store during 2015. We expect to continue to expand our store base with 36 store openings planned in fiscal 2016, of which 14 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 first quarters of fiscal 2016 and 2015 were thirteen-week periods ended April 3, 2016 and March 29, 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;

16

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- 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

17

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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 April 3, 2016 and March 29, 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 |           |
|---|----------------------|-----------|
|   | April 3,             | March 29, |
|   | 2016                 | 2015      |
| <b>Unaudited Quarterly Consolidated Statement of Operations Data:</b> |                      |           |
| Net sales   | \$993,241            | \$857,506 |
| Cost of sales, buying and occupancy                                   | 686,728              | 599,713   |
| Gross profit  | 306,513              | 257,793   |
| Direct store expenses   | 193,778              | 163,190   |
| Selling, general and administrative expenses                          | 30,896               | 24,027    |
| Store pre-opening costs   | 3,966                | 2,773     |
| Store closure and exit costs  | 37                   | 1,229     |
| Income from operations  | 77,836               | 66,574    |
| Interest expense  | (3,601 )             | (5,868 )  |
| Other income  | 101                  | 62        |
| Income before income taxes  | 74,336               | 60,768    |
| Income tax provision  | (28,129 )            | (23,301 ) |
| Net income  | \$46,207             | \$37,467  |

|                                  | Thirteen weeks ended |           |
|----------------------------------|----------------------|-----------|
|                                  | April 3,             | March 29, |
|                                  | 2016                 | 2015      |
| Comparable store sales growth(1) | 4.8 %                | 4.8 %     |

| Other Operating Data:         |     |      |
|-------------------------------|-----|------|
| Stores at beginning of period | 217 | 191  |
| Closed                        | —   | (1 ) |
| Opened                        | 11  | 10   |
| Stores at end of period       | 228 | 200  |

(1) See the explanation of “Comparable store sales growth” above under “Components of Operating Results – Net Sales.” Comparison of Thirteen Weeks Ended April 3, 2016 to Thirteen Weeks Ended

March 29, 2015

Net sales

|                               | Thirteen weeks ended |                | Change    | % Change |
|-------------------------------|----------------------|----------------|-----------|----------|
|                               | April 3, 2016        | March 29, 2015 |           |          |
| Net sales                     | \$993,241            | \$ 857,506     | \$135,735 | 16 %     |
| Comparable store sales growth | 4.8 %                | 4.8 %          |           |          |

Sales for the thirteen weeks ended April 3, 2016 totaled \$993.2 million, increasing 16% 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. Comparable stores contributed approximately 88% of total sales for the thirteen weeks ended April 3, 2016 and approximately 87% for the same period of the prior fiscal year.

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

|                                     | Thirteen weeks ended |                | Change    | %  |        |
|-------------------------------------|----------------------|----------------|-----------|----|--------|
|                                     | April 3, 2016        | March 29, 2015 |           |    | Change |
| Net sales                           | \$993,241            | \$ 857,506     | \$135,735 | 16 | %      |
| Cost of sales, buying and occupancy | 686,728              | 599,713        | 87,015    | 15 | %      |
| Gross profit                        | 306,513              | 257,793        | 48,720    | 19 | %      |
| Gross margin                        | 30.9                 | % 30.1         | % 0.8     |    | %      |

Cost of sales, buying and occupancy increased during the thirteen weeks ended April 3, 2016 compared to the thirteen weeks ended March 29, 2015, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. Gross profit increased \$40.8 million as a result of increased sales volume, and \$7.9 million related to increased margin. The gross margin increase is due to higher margins in certain categories primarily due to deflation and more normalized promotions compared to the prior year.

## Direct store expenses

|                         | Thirteen weeks ended |                | Change   | %  |        |
|-------------------------|----------------------|----------------|----------|----|--------|
|                         | April 3, 2016        | March 29, 2015 |          |    | Change |
| Direct store expenses   | \$193,778            | \$ 163,190     | \$30,588 | 19 | %      |
| Percentage of net sales | 19.5                 | % 19.0         | % 0.5    |    | %      |

Direct store expenses increased \$30.6 million, primarily due to stores opened since March 29, 2015 as well as increases in direct store expenses associated with stores operated prior to March 29, 2015. Direct store expenses, as a percentage of net sales, increased 50 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

|  | Thirteen weeks ended |                | Change  | %  |        |
|--|----------------------|----------------|---------|----|--------|
|  | April 3, 2016        | March 29, 2015 |         |    | Change |
| Selling, general and administrative expenses | \$30,896             | \$ 24,027      | \$6,869 | 29 | %      |
| Percentage of net sales                      | 3.1                  | % 2.8          | % 0.3   |    | %      |

The increase in selling, general and administrative expenses included \$2.1 million in advertising to support new stores, \$1.3 million in equity-based compensation expense due to additional grants related to management transitions during 2015, \$0.8 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 \$4.0 million for the thirteen weeks ended April 3, 2016 and \$2.8 million for the thirteen weeks ended March 29, 2015. Store pre-opening costs in the thirteen weeks ended April 3, 2016 included \$2.4 million related to opening 11 stores during that period and \$1.6 million associated with stores expected to open subsequent to quarter end. The expense for stores expected to open in future periods includes rent paid before store opening for certain acquired leases. Store pre-opening costs in the thirteen weeks ended March 29, 2015 included \$2.2 million related to opening 10 stores during that period and \$0.6 million associated with stores opened subsequent to quarter end.

Interest expense

Interest expense decreased to \$3.6 million for the thirteen weeks ended April 3, 2016 from \$5.9 million for the thirteen weeks ended March 29, 2015. The decrease in interest expense is due to 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.

#### Income tax provision

Income tax provision increased to \$28.1 million for the thirteen weeks ended April 3, 2016 from \$23.3 million for the thirteen weeks ended March 29, 2015, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 37.8% in the thirteen weeks ended April 3, 2016 from 38.3% in the thirteen weeks ended March 29, 2015. The primary reasons for the decrease in the effective tax rate were an increase in the enhanced deduction for charitable donations of food inventory, a decrease in the effective state income tax rate; partially offset by higher prior year tax credits.

#### Net income

|                         | Thirteen weeks ended |                | Change   | % Change |   |
|-------------------------|----------------------|----------------|----------|----------|---|
|                         | April 3, 2016        | March 29, 2015 |          |          |   |
| Net income              | \$46,207             | \$ 37,467      | \$ 8,740 | 23       | % |
| Percentage of net sales | 4.7                  | % 4.4          | % 0.3    |          | % |

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

#### Liquidity and Capital Resources

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

|   | Thirteen weeks ended |                |
|---|----------------------|----------------|
|   | April 3, 2016        | March 29, 2015 |
| Cash and cash equivalents at end of period      | \$ 145,650           | \$ 177,719     |
| Cash provided by operating activities           | \$ 97,947            | \$ 68,084      |
| Cash (used in) investing activities             | \$(33,476 )          | \$( 33,755 )   |
| Cash (used in) provided by financing activities | \$(54,890 )          | \$ 12,877      |

Since inception, we have financed our operations primarily through cash generated from our operations, sales of our equity 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 by operations will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including new store openings, remodel and maintenance capital expenditures at existing stores, store initiatives and other corporate capital expenditures and activities. Our cash and

cash equivalents position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within days from the related sale. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, results of operations and financial condition would be adversely affected.

#### Operating Activities

Net cash provided by operating activities increased \$29.8 million to \$97.9 million for the thirteen weeks ended April 3, 2016 compared to \$68.1 million for the thirteen weeks ended March 29, 2015. The thirteen weeks ended April 3, 2016 includes the impact of stores opened since March 29, 2015.

#### Investing Activities

Net cash used in investing activities was \$33.5 million for the thirteen weeks ended April 3, 2016 compared to \$33.8 million for the thirteen weeks ended March 29, 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 \$145 - \$155 million in fiscal 2016, 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

Net cash used in financing activities was \$54.9 million for the thirteen weeks ended April 3, 2016 compared to cash provided by financing activities of \$12.9 million for the thirteen weeks ended March 29, 2015. The change in cash used in financing activities of \$67.8 million is related to \$59.3 million of stock repurchases, a \$8.6 million decrease of excess tax benefits from the exercise of stock options, and a \$1.5 million decrease in proceeds from the exercise of stock options. These decreases in cash provided by financing activities were offset by a \$1.8 million decrease in payments on debt.

#### 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 buildings and land and certain operating leases for rental of facilities and equipment. These leases expire or become subject to renewal clauses at various dates through 2032.

The following table summarizes our lease obligations as of April 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 | 4-5 Years | More Than 5 Years |
|  | (in thousands)         |                  |           |           |                   |
| Capital and financing lease obligations(1) | \$136,229              | \$15,134         | \$30,715  | \$29,177  | \$61,203          |
| Operating lease obligations(1)             | 1,354,001              | 111,116          | 247,437   | 235,955   | 759,493           |
| Totals                                     | \$1,490,230            | \$126,250        | \$278,152 | \$265,132 | \$820,696         |

(1) Represents estimated payments for capital and financing and operating lease obligations as of April 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 \$1.5 million for the period of less than one year, \$2.2 million for years one to three, \$1.4 million for years four to five, and \$1.1 million for the period

beyond five years.

We have other contractual commitments and debt, which were presented under Contractual Obligations in our Annual Report on Form 10-K for the fiscal year ended January 3, 2016, and for which there have not been material changes since that filing through April 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 April 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 April 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 thirteen weeks ended April 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 April 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 April 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 April 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 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. 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, two complaints were filed, 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. 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 April 3, 2016.

25

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| Period (1)                         | Total number of shares purchased | Average price paid per share | Total number of shares 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) |
| January 3, 2016 - January 31, 2016 | 2,431,721                        | \$ 24.67                     | 2,431,721  | \$ 64,956,714   |

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

(2) On November 4, 2015, our Board of Directors authorized a \$150 million common stock share repurchase program. 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 purchase program may be commenced, suspended or discontinued at any time.

Item 6. Exhibits.

Exhibit

| Number | Description   |
|--------|---|
| 10.1   | 2016 Form of Performance Share Award Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan       |
| 10.2 † | 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  
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to 18 U.S.C.  
Section 1350 as  
adopted  
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Section 906 of  
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Sarbanes-Oxley  
Act of 2002

101.INS XBRL Instance  
Document

101.SCH XBRL  
Taxonomy

Extension  
Schema  
Document

XBRL  
Taxonomy  
Extension  
Calculation  
Linkbase  
101.CAL Document

XBRL  
Taxonomy  
Extension  
Definition  
Linkbase  
101.DEF Document

XBRL  
Taxonomy  
Extension Label  
Linkbase  
101.LAB Document

XBRL  
Taxonomy  
Extension  
Presentation  
Linkbase  
101.PRE Document

Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a confidential treatment order granted pursuant to a request submitted separately to the SEC pursuant to Rule 406 under the Securities Act.

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: May 5, 2016 By: /s/ Bradley S. Lukow  
Name: Bradley S. Lukow  
Title: Chief Financial Officer  
(Principal Financial Officer)

EXHIBIT INDEX

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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  
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101.LAB XBRL  
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