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Sprouts Farmers Market, Inc.
Form 10-K
February 25, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended January 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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, \$0.001 par value NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 June 28, 2015, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's voting common stock held by non-affiliates of the registrant was \$4,287,557,387, based on the last reported sale price of such stock as reported on The NASDAQ Global Select Market on such date.

As of February 24, 2016, there were outstanding 150,358,916 shares of the registrant's common stock, \$0.001 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its 2016 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K where indicated. Such Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended January 3, 2016.

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EXPLANATORY NOTE

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

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

PART I

Item 1. Business

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 224 stores in 13 states as of February 25, 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.

Our Industry

We operate within the grocery store industry which encompasses store formats ranging from small grocery and convenience stores to large independent and chain supermarkets. According to the Progressive Grocer, U.S. supermarket sales totaled over \$638 billion in 2014. Based on our industry experience, we believe we are capturing significant market share from conventional supermarkets and other specialty concepts in this supermarket segment.

The supermarket segment is comprised of various formats, including conventional, supercenter, natural / gourmet, limited assortment and warehouse. While the natural and organic food segment is one

of the fastest growing segments in the industry, conventional supermarkets have experienced overall share decline from approximately 73% in 2005 to 65% in 2014, according to the Progressive Grocer, as customers have migrated to other grocery retail formats, including specialty grocers and mass retailers. Conventional supermarket customers are attracted to competitors' unique product offerings, formats and differentiated shopping experiences.

We believe Sprouts offers consumers a compelling value relative to conventional supermarkets and mass retailers and will continue to benefit from the following industry and consumer trends:

- Increasing consumer focus on health and wellness. We believe, based on our industry experience, that consumers are increasingly focused on health and wellness and are actively seeking healthy foods in order to improve eating habits. According to SPINS LLC, a leading provider of retail consumer insights, analytics and consulting for the natural, organic and specialty products industry, sales of natural and organic products, including food and supplements, are projected to grow from \$105 billion in 2014 to over \$166 billion in 2019, representing projected annual growth of over 9%.

This overall demand for healthy products is driven by many factors, including increased awareness about the benefits of eating healthy, a greater focus on preventative health measures, and the rising costs of health care. We believe customers are attracted to retailers with comprehensive health and wellness product offerings. As a result, food retailers are offering an increased assortment of fresh, natural and organic foods as well as vitamins and supplements to meet this demand.

- Emphasis on the customer shopping experience. Consumers are increasingly focused on their shopping experience, and often choose their shopping location based on variety, price and higher-quality produce and meat. Shoppers are also loyal to their primary store, with 75% of their total grocery budget spent at their primary store according to a survey in the Food Marketing Institute's U.S. Grocery Shopper Trends 2014. Grocers are therefore focused on providing a broad selection of products along with exceptional customer service.
- Consumer desire for value. Customers across formats seek quality products at compelling value and certain traditional, natural and organic retailers have faced pressure on sales as customers shifted to lower-priced items or eliminated certain discretionary purchases. We believe consumers will continue to seek high-quality, value-priced offerings in their purchases over the long-term, regardless of macroeconomic conditions.

Growing Our Business

We believe we are well-positioned to capitalize on two powerful, long-term consumer trends—a growing interest in health and wellness and a focus on value and are pursuing a number of strategies designed to continue our growth and strong financial performance, including:

Expand our store base. We intend to continue expanding our store base by pursuing new store openings in existing markets, expanding into adjacent markets and penetrating new markets. We have opened 19, 24 and 27 new stores in fiscal 2013, 2014 and 2015, respectively, representing 14% unit growth each year. We expect to continue to expand our store base with 36 store openings planned in fiscal 2016, of which seven have opened as of the date of this Annual Report on Form 10-K, and we intend to achieve 14% annual new store growth over at least the next five years.

The below diagram shows our store footprint, by state, as of January 3, 2016.

Continue positive comparable store sales. For 35 consecutive quarters, including throughout the economic downturn from 2008 to 2010, stores under our management have achieved positive comparable store sales growth. We believe the consistency of our performance over time and across geographies and vintages is the result of a number of factors, including our distinctive value positioning and merchandising strategies, product innovation and a well-trained staff focused on customer education and engagement. We believe we can continue to grow the number and size of customer transactions by enhancing our core value proposition and distinctive customer-oriented shopping experience. We aim to grow our average ticket by continuing to expand and refine our fresh, natural and organic product offering, our targeted and personalized marketing efforts and our in-store and digital education. We believe these factors, combined with the continued strong growth in fresh, natural and organic food consumption, will allow Sprouts to gain new customers, increase customer loyalty and, over time, convert single-department trial customers into core, lifestyle customers who shop Sprouts with greater frequency and across an increasing number of departments.

Grow the Sprouts Farmers Market brand. We are committed to supporting our stores, product offerings and brand through a variety of marketing programs, private label offerings and corporate partnerships. In addition, we will continue our community outreach and charity programs to more broadly connect with our local communities with the aim of promoting our brand and educating consumers on healthy choices. We will also continue to expand our innovative marketing and promotional strategy through print, digital and social media platforms.

Our Heritage

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. As of January 3, 2016, we had 217 stores in 13 states, and are one of the largest specialty retailers of fresh, natural and organic food in the United States.

In connection with our initial public offering (referred to as our “IPO”), on July 29, 2013, Sprouts Farmers Markets, LLC, a Delaware limited liability company, converted into Sprouts Farmers Market, Inc., a Delaware corporation. As part of the corporate conversion, holders of membership interests of Sprouts Farmers Markets, LLC in the form of Class A and Class B units received 11 shares of our common stock for each unit held immediately prior to the corporate conversion, and options to purchase units became options to purchase 11 shares of our common stock for each unit underlying options outstanding immediately prior to the corporate conversion, at the same aggregate exercise price in effect prior to the corporate conversion.

On August 1, 2013, our common stock began trading on the NASDAQ Global Select Market and on August 6, 2013, we closed our IPO.

Our Stores and Operations

We believe our stores represent a blend of conventional supermarkets, farmers markets, natural foods stores, and smaller specialty markets, differentiating us from other food retailers, while also providing a complete offering for our customers.

- **Store Design.** Our stores are organized in a “flipped” conventional food retail store model, positioning our produce at the center of the store surrounded by a complete grocery offering. We typically dedicate approximately 15% of a store’s selling square footage to produce, which we believe is significantly higher than many of our peers. The stores are designed with open floor plans and low displays, intended to provide an easy-to-shop environment that allows our customers to view the entire store. The below diagram shows a sample layout of our stores:

- **Culture of Customer Engagement.** We are committed to providing and believe we have best-in-class customer engagement, which builds trust with our customers and differentiates the Sprouts shopping experience from that of many of our competitors. We design our stores to maximize customers’ interactions with our team members, as we believe this interaction provides an opportunity to educate customers and provides a valued, differentiated customer service model, which enhances customer loyalty and increases visits and purchases over time.

Customer engagement is critical to our culture and we place great importance on training our team members on customer engagement and product knowledge to ensure there is friendly, knowledgeable staff in every department. Our team members are trained and empowered to proactively engage with customers throughout the entire store. This includes investing time to educate them on the benefits of different vitamins, sharing ways to prepare a meal or cutting a piece of produce or opening a package to offer customers product tastings throughout the store. We consider customer education and engagement to be particularly important as many conventional supermarket customers that have not shopped our stores believe that eating healthy is expensive and difficult.

Our stores are typically staffed with 80 to 90 full and part-time team members including a store manager, an assistant store manager, eight department managers, five assistant department managers, store office staff and other team members.

· **Recruiting, Training, Development and Promotion.** We strive to create a strong and unified company culture and develop team members throughout the entire organization. We have prioritized making investments in training that we believe enhances our team members' knowledge, particularly with respect to our expanded and evolving product offerings, so our team members can continue to engage and assist our customers. We also have regional department level merchandisers and trainers who are focused on training team members within departments and also assist with store and local merchandising strategies and execution. For new stores, we typically have team members on site approximately three to four weeks before opening to optimize initial and long-term store performance and customer service. We also have approximately 100 people in the field as regional support teams in human resources, operations and compliance. These teams focus on hiring, retention, training, food safety, security, financial management and other operational best practices. We regularly perform audits of our stores to assess customer engagement, inventory quality and control, merchandising and other factors. We believe our team members contribute to our consistently high service standards and that this helps us successfully open new stores.

We believe Sprouts is an attractive place to work with significant growth opportunities for our team members. We regularly assess prevailing wages in the markets in which we operate and offer competitive wages and benefits as we believe active, educated and passionate team members contribute to consumer satisfaction. In 2015, we promoted approximately 4,800 team members. We also host quarterly Team Member Appreciation Days at each store, hold town hall meetings between team members and company management and provide our team members with discounts on purchases in the store.

· **Store Size.** Our stores are generally between 28,000 and 30,000 square feet, which we believe is smaller than many of our peers' average stores. Our stores are located in a variety of mid-sized and larger shopping centers, lifestyle centers and in certain cases, independent single-unit, stand-alone developments. The size of our stores and our real estate strategy provide us flexibility in site selection, including entering into new developments or existing sites formerly operated by other retailers, including other grocery banners, office supply stores, electronics retailers and other second generation space. Further, we believe our value positioning allows us to serve a diverse customer base and provides us significant flexibility to enter new markets across a variety of socio-economic areas, including markets with varying levels of fresh, natural and organic grocer penetration.

Our Product Offering

We are a complete food retailer. We focus and tailor our assortment to fresh, natural and organic foods and healthier options throughout all of our departments.

Fresh, Natural and Organic Foods

Our product offerings focus on fresh, natural and organic foods. Foods are generally considered “fresh” if it is minimally processed or in its raw state not subject to any type of preservation or freezing. Natural foods can be broadly defined as foods that are minimally processed and are free of synthetic preservatives, artificial sweeteners, colors, flavors and other additives, growth hormones, antibiotics, hydrogenated oils, stabilizers and emulsifiers. Essentially, natural foods are largely or completely free of non-naturally occurring chemicals and are as near to their whole, natural state as possible.

Organic foods refer to the food itself as well as the method by which it is produced. In general, organic operations must demonstrate that they are protecting natural resources, conserving biodiversity, and using only approved substances and must be certified by a USDA-accredited certifying agency. These organic standards include:

- Crop production must not use irradiation, sewage sludge, synthetic fertilizers, prohibited pesticides, and genetically modified organisms.
- Livestock producers must meet animal health and welfare standards, not use antibiotics or growth hormones, use 100% organic feed, and provide animals with access to the outdoors.
- Multi-ingredient organic food must be comprised of 95% or more certified organic content.

Further, retailers that handle, store or sell organic products must implement measures to protect their organic character.

Products

We categorize the varieties of products we sell as perishable and non-perishable. Perishable product categories include produce, meat, seafood, deli and bakery. Non-perishable product categories include grocery, vitamins and supplements, bulk items, dairy and dairy alternatives, frozen foods, beer and wine, and natural health and body care. The following is a breakdown of our perishable and non-perishable sales mix:

	2015	2014	2013
Perishables	50.8%	50.8%	50.1%
Non-Perishables	49.2%	49.2%	49.9%

Departments

Our stores include the following departments:

- Produce. Placed at the center of our stores, our high-quality, value-oriented offering begins with our produce department. We offer our customers a farmers market open-feel environment consisting of an abundant and affordable natural and organic offering of fresh fruits, vegetables and herbs, focused on appearance, flavor and value. Our extensive produce selection includes seasonal, specialty and organic items, often from local or regional farms, at prices targeted to be significantly lower than our competitors.
- Grocery. Our grocery offering focuses on healthy options. We carry approximately 5,400 natural and organic products in our grocery aisles, including meal components, natural sodas and other beverages, snacks and bars, baking goods, baby, pet and household items such as detergent and paper towels, and earth-friendly mercantile items. Our product offering includes more than 3,500 gluten-free items, and our own Sprouts private label brand products. We also offer distinctive locally-produced products in each of our market areas, such as preserves, honey,

BBQ sauces, salsas and chips.

·Meat and Seafood. Our Olde Tyme Butcher Shops combine high-quality sourcing through our trusted supplier network, product variety and old-fashioned customer service, as we cut and

grind meat fresh, as needed for our customers, and unlike much of the industry today, we have no offsite facility delivering products processed days in advance. We feature “choice natural” beef, pasture raised pork, grass fed organic beef, organic chicken and Grade A all-natural poultry raised cage-free from trusted partner ranches and farms. We also carry varieties of sausages made fresh daily in-store as well as an abundant selection of entrees, including gourmet burgers, pinwheels, stuffed chicken breasts, pork chops and roasts. We offer a wide variety of seafood favorites delivered up to six days a week and carry multiple options for baking, sautéing, or grilling and round out our assortment with wild fresh species while in season. We believe that our customers value the freshness, quality and service level of our meat and seafood department and this generates repeat traffic and purchases.

- **Deli.** We feature a broad array of fresh deli specialties, including high-quality sliced deli meat, salads, dips, entrees, side dishes and fresh made to order sandwiches at value prices and an abundant selection of cheeses from around the world. We have begun to roll out our new and expanded deli offerings into a select number of new stores and existing stores, including features like a new salad bar, stocked with ready to eat, healthy and flavorful salads, a full-service deli case with prepared proteins and healthy side dishes and an expanded assortment of component meals and side dishes.
- **Vitamins and Supplements.** Our stores feature more than 4,500 vitamins, supplements, natural remedies, functional food, lifestyle support, and herbal supplements. This department includes an extensive private label offering. We believe there is an education component to shopping in our vitamins and supplements department and that our customers value friendly, knowledgeable and dedicated team members to introduce products and to guide them through their purchases. We employ a full-time nutritionist to assist and train team members through online modules. Each store typically holds four to five training sessions per month (including both internal and vendor-led) to ensure our team members are knowledgeable about the products on our shelves. These training sessions prepare our vitamin and supplement team members to better educate and serve our customers through personalized service.
- **Dairy and Dairy Alternatives.** Our dairy department features a wide selection of organic, natural and regionally sourced milk, yogurt, butter and eggs, as well as a full selection of plant-based alternative dairy products.
- **Bulk Items.** Our stores can include up to 450 varieties of uniquely crafted selection of scoopable nuts, fruits, trail mixes, grains, beans, cereals, coffee, tea, spices, candy and snacks featured in the center of the store. We believe this high-quality, value-oriented department provides a feeling of an ‘old-time grocery store’ as customers are able to select and scoop as much of these items as they wish.
- **Bakery.** Our focus on fresh, high-quality and unique “signature” products is evident in our bakery department, which is located at the entrance to each store. Sprouts’ bakery offering includes artisan bread alongside a wide assortment of sandwich breads, rolls, tortillas, pitas, muffins, cookies and pies as well as sugar free, gluten free and low carbohydrate products. We bake a large selection of products fresh in-store every day to enhance the overall customer experience.
- **Frozen Foods.** Our freezer cases feature traditional and ethnic natural and organic entrees and side dishes, along with frozen vegetables, desserts and specialty items, such as gluten-free breads and non-dairy ice creams.
- **Natural Health and Body Care.** Sprouts offers approximately 2,700 natural, cruelty-free health and beauty products, old-fashioned remedies and modern body care innovations, including facial care products and make up, skin, hair, dental, baby care and grooming products, all at value-oriented prices.
- **Beer and Wine.** We offer a carefully selected assortment of craft beers, microbrews and premium beers from around the world and an expansive variety of domestic and international

wines, many of which we price at \$10 or less. We also stock Kosher, organic, sustainable and biodynamic, local, exclusive-to-Sprouts and even non-alcoholic wines.

Private Label

We have been expanding the breadth of our Sprouts branded products over the last several years and have a dedicated product development team focused on continuing this growth. These products feature competitively priced specialty and innovative products, with quality and ingredient standards that we believe equal or exceed national brands. We have increased our portfolio of private label items from approximately 800 items at the end of 2011 to approximately 1,800 as of January 3, 2016. Our private label brands drive value by offering our customers lower prices while still delivering higher margin as compared to branded products. We believe our private label products build and enhance the Sprouts brand and allow us to distinguish ourselves from our competitors, promoting customer loyalty and creating a destination shopping experience.

Sourcing and Distribution

We manage the buying of, and set the standards for, the products we sell, and we source our products from over 800 vendors and suppliers, both domestically and internationally.

We believe, based on our industry experience, that our strong relationships in the produce business provide us a competitive advantage and enable us to offer high-quality produce at prices we believe are significantly below those of conventional food retailers and even further below high-end natural and organic food retailers. Given the importance of produce to our stores, we source, warehouse and distribute all produce in-house. This ensures our produce meets our high quality standards. We are supported by dedicated regional procurement teams that provide us flexibility to procure produce on local, regional and national levels.

We have department and product specifications that ensure a consistently high level of quality across product ingredients, production standards and other key measures of freshness, natural and organic standards. These specifications are measured at both entry and exit points to our facilities. We distribute all produce to our stores from two leased distribution facilities and one third-party operated distribution facility, and we manage every aspect of quality control in this department. We believe we currently have sufficient capacity at these facilities to support our near-term growth plans, but we continue to explore expansion opportunities as our needs evolve.

We believe our scale, together with this decentralized purchasing structure and flexibility generates cost savings, which we then pass on to our customers. Distributors and farmers recognize the volume of goods we sell through our stores and our flexible purchasing and distribution model allows us to opportunistically acquire produce at great value which we will also pass along to our customers.

For all non-produce products, we use third-party distributors and vendors to distribute products directly to our stores following specifications and quality control standards that are set by us.

Nature's Best, Inc., acquired by KeHE Distributors, LLC in 2014 (referred to as "NB"), is our primary supplier of dry grocery and frozen food products, accounting for approximately 24%, 23% and 23% of our total purchases in fiscal 2015, 2014 and 2013, respectively. Another 4% of our total purchases in each of fiscal 2015, 2014 and 2013 were made through our secondary supplier, United Natural Foods, Inc. (referred to as "UNFI"). See "Risk Factors—Disruption of significant supplier relationships could negatively affect our business."

Our Customers

Our target customer seeks a wide assortment of high-quality fresh and nutritious food as well as vitamins and supplements at competitive prices. We believe our value proposition and complete grocery offering engages both conventional and health-focused shoppers.

We have a broad range of customers from those looking for value, to customers seeking specific attribute products, to those seeking to eat healthier. We believe the majority of our customers are initially attracted to our stores by our fresh produce, which we offer at prices we believe are significantly below those of conventional food retailers and even further below high-end natural and organic food retailers. We drive customer traffic by aggressively promoting produce and other items through weekly advertisements designed primarily to reach the everyday supermarket shopper. These customers include “trial” customers that limit their shopping to specific products or departments, such as produce. Through department-specific promotions, in-store signage, and customer education, many customers become “transition” customers that shop new departments and try new products. Over time, through customer service and engagement, targeted marketing, and increased knowledge of our product offering, we believe that transition customers become “lifestyle” customers that shop with greater frequency throughout the entire store.

Our Pricing, Marketing and Advertising

- Pricing. We are committed to a pricing strategy consistent with our motto of “Healthy Living for Less.” As a farmers market style store, we emphasize low prices throughout the entire store, as we are able to pass along the benefits of our scale and purchasing power to our customers. We position our prices with everyday value for our customers with regular promotions on selected products that drive traffic and trial. We typically have about 30% of our approximately 18,800 products on sale at any given time.
- Marketing and Advertising. We supplement and support our everyday competitive pricing strategy through weekly advertised specials, a weekly e-circular, online coupons and special promotions. We send over 15 million weekly advertisement circulars to encourage customers to shop at our stores. These circulars focus on product education and offerings and aim to engage the customer. We use sales flyers distributed through direct delivery or inserted into local newspapers as our primary medium for advertising. These sales flyers include representative products from our key departments. In addition, we have a customer database of over one million customers as of January 3, 2016, many of whom receive electronic versions of our weekly circulars or monthly newsletters.

We tailor our advertisements to specific markets, which provides us with greater flexibility to offer different promotions and respond to local competitive activity. In addition, we advertise our sales promotions and support our brand image through the use of local radio, as well as targeted direct mail in specific markets.

We also continue to promote and enhance our digital presence. We maintain a smartphone app and our website, www.sprouts.com, on which we display our weekly sales flyers and offer special deals and coupons and continue to expand our social media platform. Our website also features on-line ordering for holiday meals and catering trays. The inclusion of our website address in this Annual Report on Form 10-K does not include or incorporate by reference the information on or accessible through our website herein. As of January 3, 2016, we had approximately 1.3 million Facebook fans. In addition, we have partnered with Amazon Prime to offer 1-hour or 2-hour deliveries from our stores in selected pilot markets. We will continue to explore online ordering opportunities to further connect with our customers.

In addition to the weekly circulars, we offer numerous other saving opportunities for our customers, all of which are meant to reinforce our value offering and are designed to appeal to specific target customers. In 2015, we had approximately 31 department-wide promotions at

each store throughout the year, which included our Vitamin Extravaganza, Frozen Frenzy, Gluten-Free Favorites, and Incredible Bulk Sales, in addition to our routine Double-Ad Wednesday promotion and 72-Hour Sales.

Our Communities

We are actively involved in the communities in which we operate, and support many local non-profit and educational institutions that share our goal of improved health, nutrition and fitness. In 2015, we formed The Sprouts Healthy Communities Foundation (referred to as our “Foundation”), a registered 501(c)(3) organization focused on fighting food insecurity, increasing health and nutrition education and assisting those living with the daily challenges of disabilities and health concerns. Our involvement in the communities we serve, through our Foundation or our stores, takes many forms, including:

- Alignment with Certain Causes. Sprouts has undertaken a number of innovative corporate fundraising initiatives, including a multi-faceted program with Autism Speaks and the Southwest Autism Research and Resource Center. From 2010 through 2014, we raised more than \$4.9 million through our donations, as well as the donations by our and business partners. In 2015, we raised \$2.5 million including donations from our business partners and customers. Our Foundation has allowed us to expand our reach to additional causes related to its mission, including donations to REAL School Gardens to fund the creation of a school garden that promotes healthy food choices and nutrition education and to No Kid Hungry to fund nutritional programs and support free/reduced school breakfast programs for low-income students. In addition, we partnered with Vitamin Angels on two in-store fundraisers in 2015 to help connect undernourished children with life changing and lifesaving nutrients.
- Donations. Our donation goal is to contribute to the health of families and children and to healthy environments through in-kind support. Many donations are made at store level, in the form of food donations or gift cards, to qualifying organizations that are aligned with our goals. Examples include bananas or water for fundraising road races, reusable bags for health fairs and green festivals and gift cards to be used as raffle items or to provide catering for a fundraising event. During 2015, we donated over eight million pounds of produce and other food to local food banks in the markets in which we operate through our Food Rescue Program. We have also adopted the Grab & Give campaign, which encourages customers to buy bags of groceries at a discount and then allow us to donate them to food banks in the markets in which we operate.
- Volunteerism. Our team members are encouraged to help people and organizations in need. We have provided major volunteer support for the Arizona Walk Now for Autism Speaks, the Phoenix Rescue Mission, REAL School Gardens and various food banks. With an engaged base of more than 20,000 team members, we have the ability to use our leverage to support causes.

Store Selection and Economics

We have an extensive and selective process for new store site selection, which includes in-depth analysis of area demographics, competition, growth potential, traffic patterns, grocery spend and other key criteria. We have a dedicated real estate team as well as a real estate committee comprised of our Chief Development Officer and other members of senior management, including our Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer. Multiple members of our committee will also conduct an on-site inspection prior to approving any new location.

We believe that our store model, combined with our rigorous store selection process and a growing interest in health and wellness, contribute to our attractive new store returns on investment. Our typical store requires an average new store cash investment of approximately \$3.1 million, consisting of store buildout (net of contributions from landlords) of approximately \$2.6 million, and inventory (net of payables)

and cash pre-opening expenses of approximately \$0.5 million. On average, our stores reach a mature sales growth rate in three or four years after opening, with net sales increasing 20-30% during this time period. Based on our historical performance, we target net sales of \$12-\$14 million during the first year after opening and pre-tax cash-on-cash returns of 35-40% within three to four years after opening. We believe the consistent performance of our store portfolio across geographies and vintages supports the portability of the Sprouts brand and store model into a wide range of markets.

Based on our experience, we believe that our broad product offering and value proposition appeals to a wider demographic than other leading competitors, including higher-priced health food and gourmet food retailers. Sprouts has been successful across a variety of urban, suburban and rural locations in diverse geographies, from California to Georgia, underscoring the heightened interest in eating healthy across markets. We believe that the U.S. market can support approximately 1,200 Sprouts Farmers Market stores operating under our current format, and that we have significant growth opportunity in existing markets, as approximately 400 of these 1,200 potential stores are located in our current markets (13 states). We intend to achieve 14% annual new store growth over at least the next five years, with a balanced focus on existing, adjacent and new market growth.

See “Properties” for additional information with respect to our store locations.

Competition

The \$638 billion U.S. supermarket industry is large, intensely competitive and highly fragmented. We compete for customers with a wide array of food retailers, including natural and organic, specialty, conventional, mass and discount and other food retail formats. Our competitors include conventional supermarkets such as Kroger and Safeway, as well as other food retailers such as Whole Foods, Natural Grocers by Vitamin Cottage and Trader Joe’s.

Insurance and Risk Management

We use a combination of insurance and self-insurance to provide for potential liability for workers’ compensation, general liability, product liability, director and officers’ liability, team member healthcare benefits, and other casualty and property risks. Changes in legal trends and interpretations, variability in inflation rates, changes in the nature and method of claims settlement, benefit level changes due to changes in applicable laws, insolvency of insurance carriers, and changes in discount rates could all affect ultimate settlements of claims. We evaluate our insurance requirements on an ongoing basis to ensure we maintain adequate levels of coverage.

Seasonality

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

Trademarks and Other Intellectual Property

We believe that our intellectual property has substantial value and has contributed to the success of our business. In particular, our trademarks, including our registered SPROUTS FARMERS MARKET®, SPROUTS® and HEALTHY LIVING FOR LESS!® trademarks, are valuable assets that we believe reinforce our customers’ favorable perception of our stores. In addition to our trademarks, we believe that

our trade dress, which includes the human-scale design, arrangement, color scheme and other physical characteristics of our stores and product displays, is a large part of the farmers market atmosphere we create in our stores and enables customers to distinguish our stores and products from those of our competitors.

From time to time, third parties have used names similar to ours, have applied to register trademarks similar to ours and, we believe, have infringed or misappropriated our intellectual property rights. Third parties have also, from time to time, opposed our trademarks and challenged our intellectual property rights. We respond to these actions on a case-by-case basis. The outcomes of these actions have included both negotiated out-of-court settlements as well as litigation.

Information Technology Systems

We have made significant investments in information technology infrastructure, including purchasing, receiving, inventory, point of sale, warehousing, distribution, accounting, reporting and financial systems. We also maintain modern supply chain systems allowing for operating efficiencies and scalability to support our continued growth. All of our stores operate under one integrated information technology platform. We believe our current information technology infrastructure will support our growth plans but plan on continuing our history of investment in this area.

Regulatory Compliance

Our stores are subject to various local, state and federal laws, regulations and administrative practices affecting our business. We must comply with provisions regulating health and sanitation standards, food labeling, equal employment, minimum wages, environmental protection, licensing for the sale of food and, in many stores, licensing for beer and wine or other alcoholic beverages. Our operations, including the manufacturing, processing, formulating, packaging, labeling and advertising of products are subject to regulation by various federal agencies, including the Food and Drug Administration (referred to as the “FDA”), the Federal Trade Commission (referred to as the “FTC”), the U.S. Department of Agriculture (referred to as the “USDA”), the Consumer Product Safety Commission and the Environmental Protection Agency.

Food. The FDA has comprehensive authority to regulate the safety of food and food ingredients (other than meat and poultry products), as well as dietary supplements. Food additives and food contact substances are subject to pre-market approvals or notification requirements. The FDA’s overall food safety authority was dramatically enhanced in 2011 with the passage of the Food Safety Modernization Act (referred to as “FSMA”). Implementing regulations, which begin to go into effect in 2016, will require food processors and handlers to design and implement effective measures to insure food safety. Additionally, FSMA increases the FDA’s authority to institute administrative detentions of adulterated and misbranded foods. FSMA is also likely to result in enhanced tracking and tracing of food requirements and, as a result, added recordkeeping burdens upon our suppliers and contract manufacturers.

The FDA also exercises broad jurisdiction over the labeling and promotion of food. Labeling is a broad concept that, under certain circumstances, extends even to product-related claims and representations made on a company’s website or similar printed or graphic medium. All foods, including dietary supplements, must bear labeling that provides consumers with essential information with respect to ingredients, product weight, etc. The FDA administers a systematic review and approval program for certain “health claims” (claims describing the relationship between a food substance and a health or disease condition). It has also promulgated regulatory definitions for various “nutrient content claims” (e.g., “high in antioxidants,” “low in fat,” etc.). In 2014, the FDA issued a proposed rule, still pending, that would amend the nutrition facts labeling standards on food products, which if adopted, could affect our costs through mandatory label or signage updates to products sold in our deli department.

FDA and USDA Enforcement. The FDA has broad authority to enforce the provisions of the Food, Drug and Cosmetic Act (referred to as “FDCA”) applicable to the safety, labeling, manufacturing and promotion of foods and dietary supplements, including powers to issue a public warning letter to a company, publicize information about illegal products, institute an administrative detention of food, request or order a recall of illegal products from the market, and request the Department of Justice to initiate a seizure action, an injunction action or a criminal prosecution in the U.S. courts. Similarly, the USDA’s Food Safety Inspection Service is the public health agency responsible for ensuring that the nation’s commercial supply of meat, poultry and egg products is safe, wholesome and correctly labeled and packaged.

Dietary Supplements. The FDCA has been amended several times with respect to dietary supplements, in particular by the Dietary Supplement Health and Education Act of 1994 (referred to as “DSHEA”). DSHEA established a framework governing the composition, safety, labeling, manufacturing and marketing of dietary supplements, defined “dietary supplement” and “new dietary ingredient” and established new statutory criteria for evaluating the safety of substances meeting the respective definitions. In the process, DSHEA removed dietary supplements and new dietary ingredients from pre-market approval requirements that apply to food additives and pharmaceuticals and established a combination of “notification” and “post marketing controls” for regulating product safety, however, non-dietary ingredients in a dietary supplement remain subject to the FDA’s food additive authorities. DSHEA also empowered the FDA to establish binding good manufacturing practice regulations governing key aspects of the production of dietary supplements.

Food and Dietary Supplement Advertising. The FTC exercises jurisdiction over the advertising of foods and dietary supplements. The FTC has the power to institute monetary sanctions and the imposition of consent decrees and penalties that can severely limit a company’s business practices. In recent years, the FTC has instituted numerous enforcement actions against dietary supplement companies for failure to have adequate substantiation for claims made in advertising or for the use of false or misleading advertising claims.

Compliance. As is common in our industry, we rely on our suppliers and contract manufacturers to ensure that the products they manufacture and sell to us comply with all applicable regulatory and legislative requirements. In general, we seek certifications of compliance, representations and warranties, indemnification and/or insurance from our suppliers and contract manufacturers. However, even with adequate insurance and indemnification, any claims of non-compliance could significantly damage our reputation and consumer confidence in products we sell. In addition, the failure of such products to comply with applicable regulatory and legislative requirements could prevent us from marketing the products or require us to recall or remove such products from our stores. In order to comply with applicable statutes and regulations, our suppliers and contract manufacturers have from time to time reformulated, eliminated or relabeled certain of their products and we have revised certain provisions of our sales and marketing program.

Employees

As of January 3, 2016, we had more than 20,000 team members. None of our team members are subject to collective bargaining agreements. We consider our relations with our team members to be good, and we have never experienced a strike or significant work stoppage.

Corporate Offices

Our principal executive offices are located at 5455 E. High Street, Suite 111, Phoenix, Arizona 85054. Our website address is www.sprouts.com. The information on or accessible through our website is not incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the Securities and Exchange Commission (referred to as the “SEC”).

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 described below, together with all of the other information in this Annual Report on Form 10-K, including our consolidated financial statements and related notes. Any of the following risks could materially and adversely affect our business, results of operations, 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.

Business and Operating Risks

Our continued growth depends on new store openings, and our failure to successfully open new stores could negatively impact our business and stock price.

Our continued growth depends, in large part, on our ability to open new stores and to operate those stores successfully. Successful implementation of this strategy depends upon a number of factors, including our ability to effectively achieve a level of cash flow or obtain necessary financing to support our expansion; find suitable sites for new store locations; negotiate and execute leases on acceptable terms; secure and manage the inventory necessary for the launch and operation of our new stores; hire, train and retain skilled store personnel; promote and market new stores; and address competitive merchandising, distribution and other challenges encountered in connection with expansion into new geographic areas and markets. Although we plan to expand our store base primarily through new store openings, we may grow through strategic acquisitions. Our ability to grow through strategic acquisitions will depend upon our ability to identify suitable targets and negotiate acceptable terms and conditions for their acquisition, as well as our ability to obtain financing for such acquisitions, integrate the acquired stores into our existing store base and retain the customers of such stores. If we are ineffective in performing these activities, then our efforts to open and operate new stores may be unsuccessful or unprofitable, and we may be unable to execute our growth strategy.

Although we believe that the U.S. market can support approximately 1,200 Sprouts Farmers Market stores operating under our current format, we anticipate that it will take years to grow our store count to that number. We cannot assure you that we will grow our store count to approximately 1,200 stores. We opened 27 and 24 stores in fiscal 2015 and 2014, respectively, and we intend to achieve 14% annual new store growth over at least the next five years. However, we cannot assure you that we will achieve this expected level of new store growth. We may not have the level of cash flow or financing necessary to support our growth strategy. Additionally, our proposed expansion will place increased demands on our operational, managerial and administrative resources. These increased demands could cause us to operate our existing business less effectively, which in turn could cause deterioration in the financial performance of our existing stores. Further, new store openings in markets where we have existing stores may result in reduced sales volumes at our existing stores in those markets. If we experience a decline in performance, we may slow or discontinue store openings, or we may decide to close stores that we are unable to operate in a profitable manner. If we fail to successfully implement our growth strategy, including by opening new stores, our financial condition and results of operations may be adversely affected.

On many of our projects, including build-to-suit and existing repurposed locations, we have received landlord contributions for leasehold improvements and other build-out costs. We cannot guarantee that we will be able to continue to receive landlord contributions at the same levels or at all. Any reductions of landlord contributions could have an adverse impact on our new store cash-on-cash returns and our operating results.

We may be unable to maintain or increase comparable store sales, which could negatively impact our business and stock price.

We may not be able to maintain or improve the levels of comparable store sales that we have experienced in the past. Our comparable store sales growth could be lower than our historical average for many reasons, including:

- general economic conditions;
- slowing in the fresh, natural and organic retail sector;
- the impact of new and acquired stores entering into the comparable store base;
- the opening of new stores that cannibalize store sales in existing areas;
- increased competitive activity;
- price changes in response to competitive factors;
- possible supply shortages;
- cycling against any year of above-average sales results;
- consumer preferences, buying trends and spending levels;
- product price inflation or deflation;
- the number and dollar amount of customer transactions in our stores;
- our ability to provide product offerings that generate new and repeat visits to our stores; and
- the level of customer engagement that we provide in our stores.

These factors may cause our comparable store sales results to be materially lower than in recent periods, which could harm our business and result in a decline in the price of our common stock.

Disruption of significant supplier relationships could negatively affect our business.

NB is our primary supplier of dry grocery and frozen food products, accounting for approximately 24% and 23% of our total purchases in each of fiscal 2015 and 2014, respectively. We also have commitments in place with NB to order certain amounts of our distribution-sourced organic and natural produce, and to maintain certain minimum average annual store purchase volumes, including for any new stores we open. Our current contractual relationship with NB continues through April 2018. Due to this concentration of purchases from a single third-party supplier, the cancellation of our distribution arrangement or the disruption, delay or inability of NB to deliver product to our stores in quantities that meet our requirements may materially and adversely affect our operating results while we establish alternative distribution channels. Another 4% of our total purchases in each of fiscal 2015 and 2014 were made through our secondary supplier, UNFI. Our current contractual relationship with UNFI continues through December 31, 2018. There is no assurance UNFI or other distributors will be able to fulfill our needs on favorable terms or at all. In addition, if NB, UNFI or any of our other suppliers fail to comply with food safety, labeling or other laws and regulations, or face allegations of non-compliance, their operations may be disrupted. Further, the food distribution and manufacturing industries are dynamic. Consolidation of distributors or the manufacturers that supply them could reduce our supply options and detrimentally impact the terms under which we purchase products. We cannot assure you that we would be able to find replacement suppliers on commercially reasonable terms, which would have a material adverse effect on our financial condition and results of operations.

Any significant interruption in the operations of our distribution centers or supply chain network could disrupt our ability to deliver our produce and other products in a timely manner.

We self-distribute our produce through our two distribution centers located in Arizona and Texas and a third-party distribution center in California. Any significant interruption in the operation of our

distribution center infrastructure, such as disruptions due to fire, severe weather or other catastrophic events, power outages, labor disagreements, shipping problems, or contractual disputes with third-party service providers could adversely impact our ability to distribute produce to our stores. Such interruptions could result in lost sales and a loss of customer loyalty to our brand. While we maintain business interruption and property insurance, if the operation of our distribution centers were interrupted for any reason causing delays in shipment of produce to our stores, our insurance may not be sufficient to cover losses we experience, which could have a material adverse effect on our business, financial condition and results of operations.

In addition, unexpected delays in deliveries from vendors that ship directly to our stores or increases in transportation costs (including through increased fuel costs) could have a material adverse effect on our financial condition and results of operations. Labor shortages or work stoppages in the transportation industry, long-term disruptions to the national and international transportation infrastructure, reduction in capacity and industry-specific regulations such as hours-of-service rules that lead to delays or interruptions of deliveries could negatively affect our business.

Disruptions to, or security breaches involving, our information technology systems could harm our ability to run our business.

We rely extensively on information technology systems for point of sale processing in our stores, supply chain, financial reporting, human resources and various other processes and transactions. Our information technology systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, including breaches of our transaction processing or other systems that could result in the compromise of confidential customer data, catastrophic events, and usage errors by our team members. In January 2013, we discovered sophisticated malware installed on certain credit card “pin pads” in a limited number of our stores designed to illegally access our customers’ credit card information. We discovered the malware shortly after it was planted and promptly shut down its access to our systems. In connection with the January 2013 breach, in addition to replacing the affected card terminals for a total cost of approximately \$170,000, we engaged a nationally recognized cybersecurity firm to investigate the incident. The costs associated with the investigation, and penalties assessed by our credit card vendors, are covered by our insurance policy, subject to our insurance deductible of \$100,000. We have implemented numerous additional security protocols since the attack in order to further tighten security, but there can be no assurance similar breaches will not occur in the future, be detected in a timely manner or be covered by our insurance policy.

Our information technology systems may also fail to perform as we anticipate, and we may encounter difficulties in adapting these systems to changing technologies or expanding them to meet the future needs of our business. If our systems are breached, damaged or cease to function properly, we may have to make significant investments to fix or replace them, suffer interruptions in our operations, incur liability to our customers and others, face costly litigation, and our reputation with our customers may be harmed. Various third parties, such as our suppliers and payment processors, also rely heavily on information technology systems, and any failure of these systems could also cause loss of sales, transactional or other data and significant interruptions to our business. Any material interruption in the information technology systems we rely on may have a material adverse effect on our operating results and financial condition.

If we are unable to successfully identify market trends and react to changing consumer preferences in a timely manner, our sales may decrease.

We believe our success depends, in substantial part, on our ability to:

- anticipate, identify and react to natural and organic grocery and dietary supplement trends and changing consumer preferences and demographics in a timely manner;

- translate market trends into appropriate, saleable product and service offerings in our stores before our competitors; and

- develop and maintain vendor relationships that provide us access to the newest merchandise on reasonable terms.

Consumer preferences often change rapidly and without warning, moving from one trend to another among many product or retail concepts. Our performance is impacted by trends regarding healthy lifestyles, dietary preferences, natural and organic products, and vitamins and supplements. Consumer preferences towards vitamins, supplements or natural and organic food products might shift as a result of, among other things, economic conditions, food safety perceptions, scientific research or findings regarding the benefits or efficacy of such products, national media attention and the cost of these products. Our store offerings currently include natural and organic products and dietary supplements. A change in consumer preferences away from our offerings would have a material adverse effect on our business. Additionally, negative publicity over the safety, efficacy or benefits of any such items may adversely affect demand for our products, and could result in lower customer traffic, sales and results of operations.

If we are unable to anticipate and satisfy consumer preferences in the regions where we operate, our sales may decrease, which could have a material adverse effect on our business, financial condition and results of operations.

Our newly opened stores may negatively impact our financial results in the short-term, and may not achieve sales and operating levels consistent with our more mature stores on a timely basis or at all.

We have actively pursued new store growth and plan to continue doing so in the future. We cannot assure you that our new store openings will be successful or reach the sales and profitability levels of our existing stores. New store openings may negatively impact our financial results in the short-term due to the effect of store opening costs and lower sales and contribution to overall profitability during the initial period following opening. New stores build their sales volume and their customer base over time and, as a result, generally have lower margins and higher operating expenses, as a percentage of net sales, than our more mature stores. New stores may not achieve sustained sales and operating levels consistent with our more mature store base on a timely basis or at all. This may have an adverse effect on our financial condition and operating results.

In addition, we may not be able to successfully integrate new stores into our existing store base and those new stores may not be as profitable as our existing stores. Further, we have experienced in the past, and expect to experience in the future, some sales volume transfer from our existing stores to our new stores as some of our existing customers switch to new, closer locations. If our new stores are less profitable than our existing stores, or if we experience sales volume transfer from our existing stores, our financial condition and operating results may be adversely affected.

We may be unable to maintain or improve our operating margins, which could adversely affect our financial condition and ability to grow.

If we are unable to successfully manage the potential difficulties associated with store growth, we may not be able to capture the efficiencies of scale that we expect from expansion. If we are not able to continue to capture efficiencies of scale, improve our systems, continue our cost discipline, and maintain appropriate store labor levels and disciplined product selection, our operating margins may stagnate or decline. In addition, competition and pricing pressures from competitors may also adversely impact our operating margins. Both efficiencies from scale and competition could have a material adverse effect on our business, financial condition and results of operations and adversely affect the price of our common stock.

Real or perceived concerns that products we sell could cause unexpected side effects, illness, injury or death could result in their discontinuance or expose us to lawsuits, either of which could result in unexpected costs and damage to our reputation.

There is increasing governmental scrutiny of and public awareness regarding food safety. Unexpected side effects, illness, injury, or death caused by products we prepare and/or sell or involving vendors that supply us with products could result in the discontinuance of sales of these products or our relationship with such vendors or prevent us from achieving market acceptance of the affected products. Such side effects, illnesses, injuries and death could also expose us to product liability or negligence lawsuits. Any claims brought against us may exceed our existing or future insurance policy coverage or limits. Any judgment against us that is in excess of our policy limits would have to be paid from our cash reserves, which would reduce our capital resources. Further, we may not have sufficient capital resources to pay a judgment, in which case our creditors could levy against our assets.

As a fresh, natural and organic retailer, we believe that many customers choose to shop our stores because of their interest in health, nutrition and food safety. As a result, we believe that our customers hold us to a high food safety standard. Therefore, real or perceived quality or food safety concerns, whether or not ultimately based on fact, and whether or not involving products sold at our stores or vendors that supply us with products, would cause negative publicity and lost confidence regarding our company, brand, or products, which could in turn harm our reputation and net sales, and could have a material adverse effect on our business, results of operations or financial condition.

If we fail to maintain our reputation and the value of our brand, our sales may decline.

We believe our continued success depends on our ability to maintain and grow the value of the Sprouts brand. Maintaining, promoting and positioning our brand and reputation will depend largely on the success of our marketing and merchandising efforts and our ability to provide a consistent, high-quality customer experience. Brand value is based in large part on perceptions of subjective qualities, and even isolated incidents involving our company, our suppliers or the products we sell can erode trust and confidence, particularly if they involve our private label products, or result in adverse publicity, governmental investigations or litigation. Our brand could be adversely affected if we fail to achieve these objectives, or if our public image or reputation were to be tarnished by negative publicity.

The loss of key management could negatively affect our business.

We are dependent upon a number of key management and other team members. If we were to lose the services of a significant number of key team members within a short period of time, this could have a material adverse effect on our operations as we may not be able to find suitable individuals to replace them on a timely basis, if at all. In addition, any such departure could be viewed in a negative light by investors and analysts, which may cause our stock price to decline. We do not maintain key person insurance on any team member.

If we are unable to attract, train and retain team members, we may not be able to grow or successfully operate our business.

The food retail industry is labor intensive. Our continued success is dependent upon our ability to attract and retain qualified team members in our stores and at our regional and store support offices who understand and appreciate our culture and are able to represent our brand effectively and establish credibility with our business partners and consumers. We face intense competition for qualified team members, many of whom are subject to offers from competing employers. Our ability to meet our labor needs, while controlling wage and labor-related costs, is subject to numerous external factors, including the availability of a sufficient number of qualified persons in the work force in the markets in which we are located, unemployment levels within those markets, unionization of the available work force, prevailing wage rates, changing demographics, health and other insurance costs and changes in employment

legislation. In the event of increasing wage rates, if we fail to increase our wages competitively, the quality of our workforce could decline, causing our customer engagement to suffer, while increasing our wages

could cause our earnings to decrease. If we are unable to hire and retain team members capable of meeting our business needs and expectations, our business and brand image may be impaired. Any failure to meet our staffing needs or any material increase in turnover rates of our team members or team member wages may adversely affect our business, results of operations or financial condition.

Union attempts to organize our team members could negatively affect our business.

None of our team members are currently subject to a collective bargaining agreement. As we continue to grow and enter different regions, unions may attempt to organize all or part of our team member base at certain stores or within certain regions. Responding to such organization attempts may distract management and team members and may have a negative financial impact on individual stores, or on our business as a whole.

Our lease obligations could adversely affect our financial performance and may require us to continue paying rent for store locations that we no longer operate.

We are subject to risks associated with our current and future store, distribution center and administrative office real estate leases. Our high level of fixed lease obligations will require us to use a portion of cash generated by our operations to satisfy these obligations, and could adversely impact our ability to obtain future financing, if required, to support our growth or other operational investments. We will require substantial cash flows from operations to make our payments under our operating leases, all of which provide for periodic increases in rent. If we are not able to make the required payments under the leases, the lenders or owners of the relevant stores, distribution centers or administrative offices may, among other things, repossess those assets, which could adversely affect our ability to conduct our operations. In addition, our failure to make payments under our operating leases could trigger defaults under other leases or under agreements governing our indebtedness, which could cause the counterparties under those agreements to accelerate the obligations due thereunder.

Further, we generally cannot cancel our leases, so if we decide to close or relocate a location, we may nonetheless be committed to perform our obligations under the applicable lease, including paying the base rent for the remaining lease term. In addition, as our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or any terms at all, which could materially adversely affect our business, results of operations or financial condition.

Claims under our insurance plans may differ from our estimates, which could materially impact our results of operations.

We use a combination of insurance and self-insurance plans to provide for the potential liabilities for workers' compensation, general liability (including, in connection with legal proceedings described under "—Legal proceedings could materially impact our business, financial condition and results of operations" below), property insurance, director and officers' liability insurance, vehicle liability and team member health-care benefits. Liabilities associated with the risks that are retained by us are estimated, in part, by considering historical claims experience, demographic factors, severity factors and other actuarial assumptions. Our results could be materially impacted by claims and other expenses related to such plans if future occurrences and claims differ from these assumptions and historical trends.

We may be unable to generate sufficient cash flow to satisfy our debt service obligations, which could adversely impact our business.

As of January 3, 2016, we had outstanding indebtedness of \$160.0 million under our credit agreement (referred to as the "Credit Facility"). We may incur additional indebtedness in the future, including borrowings under our Credit Facility. Our indebtedness, or any additional indebtedness we may incur, could require us to divert funds identified for

other purposes for debt service and impair our liquidity position. If we cannot generate sufficient cash flow from operations to service our debt, we may need to

refinance our debt, dispose of assets or issue equity to obtain necessary funds. We do not know whether we will be able to take any of such actions on a timely basis, on terms satisfactory to us or at all.

The fact that a substantial portion of our cash flow from operations could be needed to make payments on this indebtedness could have important consequences, including the following:

- reducing our ability to execute our growth strategy, including new store development;
- impacting our ability to continue to execute our operational strategies in existing stores;
- increasing our vulnerability to general adverse economic and industry conditions;
- reducing the availability of our cash flow for other purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business and the market in which we operate, which would place us at a competitive disadvantage compared to our competitors that may have less debt;
- limiting our ability to borrow additional funds; and
- failing to comply with the covenants in our debt agreements could result in negative consequences, including all of our indebtedness becoming immediately due and payable.

Our ability to obtain necessary funds through borrowing will depend on our ability to generate cash flow from operations. Our ability to generate cash is subject to general economic, financial, competitive, legislative, regulatory, and other factors that are beyond our control. If our business does not generate sufficient cash flow from operations or if future borrowings are not available to us under our Credit Facility or otherwise in amounts sufficient to enable us to fund our liquidity needs, our operating results and financial condition may be adversely affected. Our inability to make scheduled payments on our debt obligations in the future would require us to refinance all or a portion of our indebtedness on or before maturity, sell assets, delay capital expenditures, or seek additional equity investment.

Covenants in our debt agreements restrict our operational flexibility.

The agreement governing our Credit Facility contains usual and customary restrictive covenants relating to our management and the operation of our business, including the following:

- incurring additional indebtedness;
- making certain investments;
- merging, dissolving, liquidating, consolidating, or disposing of all or substantially all of our assets;
- paying dividends, making distributions, or redeeming capital stock;
- entering into transactions with our affiliates; and
- granting liens on our assets.

Our Credit Facility also requires us to maintain a specified total net leverage ratio and minimum interest coverage ratio at the end of any fiscal quarter at any time the facility is drawn. Our ability to meet these ratios, if applicable, could be affected by events beyond our control. Failure to comply with any of the covenants under our Credit Facility could result in a default under the facility, which could cause our lenders to accelerate the timing of payments and exercise their lien on substantially all of our assets, which would have a material adverse effect on our business, operating results, and financial condition.

Market and Other External Risks

Competition in our industry is intense, and our failure to compete successfully may adversely affect our revenues and profitability.

We operate in the highly competitive retail food industry. Our competitors include supermarkets, natural food stores, mass or discount retailers, warehouse membership clubs, online retailers and specialty stores. These retailers compete with us for products, customers and locations. We compete on a combination of factors, primarily product selection and quality, customer engagement, store format, location and price. Our success depends on our ability to offer products that appeal to our customers' preferences, and our failure to offer such products could lead to a decrease in our sales. To the extent that our competitors lower prices, our ability to maintain profit margins and sales levels may be negatively impacted. In addition, some competitors are aggressively expanding their number of stores or their product offerings or increasing the space allocated to perishable and specialty foods, including fresh, natural and organic foods. Some of these competitors may have been in business longer or may have greater financial or marketing resources than we do and may be able to devote greater resources to sourcing, promoting and selling their products. As competition in certain areas intensifies or competitors open stores within close proximity to our stores, our results of operations may be negatively impacted through a loss of sales, decrease in market share, reduction in margin from competitive price changes or greater operating costs.

We rely heavily on sales of fresh produce and quality natural and organic products, and product supply disruptions may have an adverse effect on our profitability and operating results.

We have a significant focus on perishable products, including fresh produce and natural and organic products. Sales of produce accounted for approximately 25% and 26% of our net sales in fiscal 2015 and 2014, respectively. Although we have not experienced difficulty to date in maintaining the supply of our produce and fresh, natural and organic products that meet our quality standards, there is no assurance that these products will be available to meet our needs in the future. The availability of such products at competitive prices depends on many factors beyond our control, including the number and size of farms that grow natural or organic crops or raise livestock that meet our quality, welfare and production standards and the ability of our vendors to maintain organic, non-genetically modified or other applicable third-party certifications for such products. Produce is also vulnerable to adverse weather conditions and natural disasters, such as floods, droughts, storms, frosts, earthquakes, hurricanes and pestilences. Adverse weather conditions and natural disasters can lower crop yields and reduce crop size and quality, which in turn could reduce the available supply of, or increase the price of, fresh produce, which may adversely impact sales of our fresh produce and our other products that rely on produce as a key ingredient.

In addition, we and our suppliers compete with other food retailers in the procurement of fresh, natural and organic products, which are often less available than conventional products. If our competitors significantly increase their fresh, natural and organic product offerings due to increases in consumer demand or otherwise, we and our suppliers may not be able to obtain a sufficient supply of such products on favorable terms, or at all, and our sales may decrease, which could have a material adverse effect on our business, financial condition and results of operations. We could also suffer significant inventory losses in the event of disruption of our distribution network or extended power outages in our distribution centers. If we are unable to maintain inventory levels suitable for our business needs, it would materially adversely affect our financial condition and results of operations.

General economic conditions that impact consumer spending could adversely affect our business.

The retail food business is sensitive to changes in general economic conditions. Recessionary economic cycles, increases in interest rates, higher prices for commodities, fuel and other energy, inflation, high levels of unemployment and consumer debt, depressed home values, high tax rates and other economic factors that affect

consumer spending and confidence or buying habits may materially adversely affect the demand for products we sell in our stores. In recent years, the U.S. economy has

experienced volatility due to uncertainties related to energy prices, credit availability, difficulties in the banking and financial services sectors, decreases in home values and retirement accounts, instability in foreign markets, high unemployment and falling consumer confidence. As a result, consumers are more cautious and could shift their spending to lower-priced competition, such as warehouse membership clubs, dollar stores or extreme value formats, which could have a material and adverse effect on our operating results and financial condition.

In addition, inflation or deflation can impact our business. Food deflation, particularly in produce, could reduce sales growth and earnings if our competitors react by lowering their retail pricing, while food inflation, when combined with reduced consumer spending, could reduce sales and gross profit margins. As a result, our operating results and financial condition could be materially adversely affected.

Higher wage and benefit costs could adversely affect our business.

Changes in federal and state minimum wage laws and other laws relating to employee benefits, including the Patient Protection and Affordable Care Act, could cause us to incur additional wage and benefit costs. Increased labor costs brought about by changes in minimum wage laws, other regulations or prevailing market conditions would increase our expenses and have an adverse impact on our profitability.

The current geographic concentration of our stores creates an exposure to local or regional downturns or catastrophic occurrences.

As of January 3, 2016, we operated 82 stores in California, making California our largest market representing 38% of our total stores and 42% of our net sales in Fiscal 2015. We also have store concentration in Texas, Arizona and Colorado, operating 37, 29 and 27 stores in those states, respectively, and representing 42% in the aggregate of our net sales in the Fiscal 2015. In addition, we source a large portion of our produce from California, ranging from approximately 40% to approximately 70% depending on the time of year. As a result, our business is currently more susceptible to regional conditions than the operations of more geographically diversified competitors, and we are vulnerable to economic downturns in those regions. Any unforeseen events or circumstances that negatively affect these areas in which we have stores or from which we obtain products could materially adversely affect our revenues and profitability. These factors include, among other things, changes in demographics, population and employee bases, wage increases, changes in economic conditions, severe weather conditions and other catastrophic occurrences. Such conditions may result in reduced customer traffic and spending in our stores, physical damage to our stores, loss of inventory, closure of one or more of our stores, inadequate work force in our markets, temporary disruption in the supply of products, delays in the delivery of goods to our stores and a reduction in the availability of products in our stores. Any of these factors may disrupt our business and materially adversely affect our financial condition and results of operations.

Increased commodity prices and availability may impact profitability.

Many products we sell include ingredients such as wheat, corn, oils, milk, sugar, cocoa and other key commodities. Many commodity prices worldwide have been increasing. Any increase in prices of such key ingredients may cause our vendors to seek price increases from us. We cannot assure you that we will be able to mitigate vendor efforts to increase our costs, either in whole or in part. In the event we are unable to continue mitigating potential vendor price increases, we may in turn consider raising our prices, and our customers may be deterred by any such price increases. Our profitability may be impacted through increased costs to us which may impact gross margins, or through reduced revenue as a result of a decline in the number and average size of customer transactions.

Increases in certain costs affecting our marketing, advertising and promotions may adversely impact our ability to advertise effectively and reduce our profitability.

Postal rate increases, and increasing paper and printing costs affect the cost of our promotional mailings. In response to any future increase in mailing costs, we may consider reducing the number and size of certain promotional pieces. In addition, we rely on discounts from the basic postal rate structure, such as discounts for bulk mailings and sorting by zip code and carrier routes. We are not party to any long-term contracts for the supply of paper. Future increases in costs affecting our marketing, advertising and promotions could adversely impact our ability to advertise effectively and our profitability.

A widespread health epidemic could materially impact our business.

Our business could be severely impacted by a widespread regional, national or global health epidemic. A widespread health epidemic may cause customers to avoid public gathering places such as our stores or otherwise change their shopping behaviors. Additionally, a widespread health epidemic could also adversely impact our business by disrupting production and delivery of products to our stores and by impacting our ability to appropriately staff our stores.

We may require additional capital to fund the expansion of our business, and our inability to obtain such capital could harm our business.

To support our expanding business, we must have sufficient capital to continue to make significant investments in our new and existing stores and advertising. We cannot assure you that cash generated by our operations will be sufficient to allow us to fund such expansion. If cash flows from operations are not sufficient, we may need additional equity or debt financing to provide the funds required to expand our business. If such financing is not available on satisfactory terms or at all, we may be unable to expand our business or to develop new business at the rate desired and our operating results may suffer. Debt financing increases expenses, may contain covenants that restrict the operation of our business, and must be repaid regardless of operating results. Equity financing, or debt financing that is convertible into equity, could result in additional dilution to our existing stockholders.

Our inability to obtain adequate capital resources, whether in the form of equity or debt, to fund our business and growth strategies may require us to delay, scale back or eliminate some or all of our operations or the expansion of our business, which may have a material adverse effect on our business, operating results, financial condition or prospects.

Increasing energy costs, unless offset by more efficient usage or other operational responses, may impact our profitability.

We utilize natural gas, water, sewer and electricity in our stores and use gasoline and diesel in trucks that deliver products to our stores. We may also be required to pay certain adjustments or other amounts pursuant to our supply and delivery contracts in connection with increases in fuel prices. Increases in energy costs, whether driven by increased demand, decreased or disrupted supply, increased environmental regulations or an anticipation of any such events will increase the costs of operating our stores. Although fuel prices declined during the second half of 2014 and persisted through 2015, our shipping costs also may increase if fuel and freight prices increase. We may not be able to recover these rising costs through increased prices charged to our customers, and any increased prices may exacerbate the risk of customers choosing lower-cost alternatives. In addition, if we are unsuccessful in attempts to protect against these increases in energy costs through long-term energy contracts, improved energy procurement, improved efficiency and other operational improvements, the overall costs of operating our stores will increase, which would impact our profitability, financial condition and results of operations.

Financial Reporting, Legal and Other Regulatory Risks

We, as well as our vendors, are subject to numerous laws and regulations and our compliance with these laws and regulations may increase our costs, limit or eliminate our ability to sell certain products, raise regulatory enforcement risks not present in the past, or otherwise adversely affect our business, reputation, results of operations and financial condition.

As a retailer of food, vitamins and supplements and a seller of many of our private label products, we are subject to numerous health and safety laws and regulations. Our suppliers and contract manufacturers are also subject to such laws and regulations. These laws and regulations apply to many aspects of our business, including the manufacturing, packaging, labeling, distribution, advertising, sale, quality and safety of products we sell, as well as the health and safety of our team members and the protection of the environment. We are subject to regulation by various government agencies, including the FDA, the USDA, the FTC, the Occupational Safety and Health Administration, the Consumer Product Safety Commission and the Environmental Protection Agency, as well as various state and local agencies.

We are also subject to the USDA's Organic Rule, which facilitates interstate commerce and the marketing of organically produced food, and provides assurance to our customers that such products meet consistent, uniform standards. Compliance with the USDA's Organic Rule also places a significant burden on some of our suppliers, which may cause a disruption in some of our product offerings.

As a retailer of supplements, our sales of vitamins and supplements are regulated under DSHEA, a statute which is administered by the FDA as part of its responsibilities under the FDCA. DSHEA expressly permits vitamins and supplements to bear statements describing how a product affects the structure, function and/or general well-being of the body. However, no statement may expressly or implicitly represent that a supplement will diagnose, cure, mitigate, treat or prevent a disease.

New or revised government laws and regulations, such as FSMA, passed in January 2011, portions of which go into effect in 2016, grant the FDA greater authority over the safety of the national food supply, as well as increased enforcement by government agencies, and could result in additional compliance costs and civil remedies. Such regulations mandate that risk-based preventive controls be observed by the majority of food producers. This authority applies to all domestic food facilities and, by way of imported food supplier verification requirements, to all foreign facilities that supply food products.

With respect to both food and dietary supplements, FSMA meaningfully augments the FDA's ability to access a producer's records and a supplier's records. This increased access could permit the FDA to identify areas of concern it had not previously considered to be problematic either for us or for our suppliers. FSMA is also likely to result in enhanced tracking and tracing of food requirements and, as a result, added recordkeeping burdens upon our suppliers. In addition, under FSMA, the FDA has the authority to inspect certifications and therefore evaluate whether foods and ingredients from our suppliers are compliant with the FDA's regulatory requirements. Such inspections may delay the supply of certain products or result in certain products being unavailable to us for sale in our stores.

DSHEA established that no notification to the FDA is required to market a dietary supplement if it contains only dietary ingredients that were present in the U.S. food supply prior to DSHEA's enactment. However, for a dietary ingredient not present in the food supply prior to DSHEA's enactment, the manufacturer is required to provide the FDA with information supporting the conclusion that the ingredient will reasonably be expected to be safe at least 75 days before introducing a new dietary ingredient into interstate commerce. This or similar informational requirements could materially adversely affect the availability of dietary supplement products.

The FDA has broad authority to enforce the provisions of the FDCA applicable to the safety, labeling, manufacturing and promotion of foods and dietary supplements, including powers to issue a public warning letter to a company, publicize information about illegal products, institute an administrative detention of food, request or order a recall of illegal products from the market, and request the

Department of Justice to initiate a seizure action, an injunction action or a criminal prosecution in the U.S. courts.

In connection with the marketing and advertisement of products we sell, we could be the target of claims relating to false or deceptive advertising, including under the auspices of the FTC and the consumer protection statutes of some states. Furthermore, in recent years, the FDA has been aggressive in enforcing its regulations with respect to nutrient content claims (e.g., “low fat,” “good source of,” “calorie free,” etc.), unauthorized “health claims” (claims that characterize the relationship between a food or food ingredient and a disease or health condition), and other claims that impermissibly suggest therapeutic benefits for certain foods or food components. These events could interrupt the marketing and sales of products in our stores, including our private label products, severely damage our brand reputation and public image, increase the cost of products in our stores, result in product recalls or litigation, and impede our ability to deliver merchandise in sufficient quantities or quality to our stores, which could result in a material adverse effect on our business, financial condition and results of operations.

Our reputation could also suffer from real or perceived issues involving the labeling or marketing of products we sell as “natural.” Although the FDA and the USDA have each issued statements regarding the appropriate use of the word “natural,” and the FDA has requests for comment now pending on the issue, there is no single, U.S. government-regulated definition of the term “natural” for use in the food industry. The resulting uncertainty has led to consumer confusion, distrust and legal challenges. Plaintiffs have commenced legal actions against a number of food companies and retailers that market “natural” products, asserting false, misleading and deceptive advertising and labeling claims, including claims related to genetically modified ingredients. Should we become subject to similar claims, consumers may avoid purchasing products from us or seek alternatives, even if the basis for the claim is unfounded. Adverse publicity about these matters may discourage consumers from buying our products. The cost of defending against any such claims could be significant. Any loss of confidence on the part of consumers in the truthfulness of our labeling or ingredient claims would be difficult and costly to overcome and may significantly reduce our brand value. Any of these events could adversely affect our reputation and brand and decrease our sales, which would have a material adverse effect on our business, financial condition and results of operations.

We are also subject to laws and regulations more generally applicable to retailers. Compliance with such laws and regulations may increase our costs, limit or eliminate our ability to sell certain products or otherwise adversely affect our business, reputation, results of operations or financial condition.

We are also subject to laws and regulations more generally applicable to retailers, including labor and employment, taxation, zoning and land use, environmental protection, workplace safety, public health, community right-to-know and alcoholic beverage sales. Our stores are subject to unscheduled inspections on a regular basis, which, if violations are found, could result in the assessment of fines, suspension of one or more needed licenses and, in the case of repeated “critical” violations, closure of the store until a re-inspection demonstrates that we have remediated the problem. Further, our new store openings could be delayed or prevented or our existing stores could be impacted by difficulties or failures in our ability to obtain or maintain required approvals or licenses. In addition, we are subject to environmental laws pursuant to which we could be held responsible for all of the costs or liabilities relating to any contamination at our or our predecessors’ past or present facilities and at third-party waste disposal sites, regardless of our knowledge of, or responsibility for, such contamination, and such costs may exceed our environmental liability insurance coverage.

As is common in our industry, we rely on our suppliers and contract manufacturers to ensure that the products they manufacture and sell to us comply with all applicable regulatory and legislative requirements. In general, we seek certifications of compliance, representations and warranties, indemnification and/or insurance from our suppliers and contract manufacturers. However, even with adequate insurance and indemnification, any claims of non-compliance could significantly damage our reputation and consumer confidence in our products. In order to comply with applicable statutes and regulations, our suppliers and contract manufacturers have from time to time reformulated,

eliminated or

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re-labeled certain of their products and we have revised certain provisions of our sales and marketing program.

We cannot predict the nature of future laws, regulations, interpretations or applications, or determine what effect either additional government regulations or administrative orders, when and if promulgated, or disparate federal, state and local regulatory schemes would have on our business in the future. They could, however, increase our costs or require the reformulation of certain products to meet new standards, the recall or discontinuance of certain products not able to be reformulated, additional recordkeeping, expanded documentation of the properties of certain products, expanded or different labeling and/or scientific substantiation. Any or all of such requirements could have a material adverse effect on our business, financial condition and results of operations.

Legal proceedings could materially impact our business, financial condition and results of operations.

Our operations, which are characterized by a high volume of customer traffic and by transactions involving a wide variety of product selections, carry a higher exposure to consumer litigation risk when compared to the operations of companies operating in some other industries. Consequently, we may be a party to individual personal injury, product liability, intellectual property, employment-related and other legal actions in the ordinary course of our business, including litigation arising from food-related illness or product labeling. The outcome of litigation, particularly class action lawsuits, is difficult to assess or quantify. Plaintiffs in these types of lawsuits may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to such lawsuits may remain unknown for substantial periods of time. While we maintain insurance, insurance coverage may not be adequate, and the cost to defend against future litigation may be significant. There may also be adverse publicity associated with litigation that may decrease consumer confidence in our business, regardless of whether the allegations are valid or whether we are ultimately found liable. As a result, litigation may materially adversely affect our business, financial condition, and results of operations.

We may be unable to adequately protect our intellectual property rights, which could harm our business.

We rely on a combination of trademark, trade secret, copyright and domain name law and internal procedures and nondisclosure agreements to protect our intellectual property. In particular, we believe our trademarks, including SPROUTS FARMERS MARKET®, SPROUTS® and HEALTHY LIVING FOR LESS!®, and our domain names, including sprouts.com, are valuable assets. However, there can be no assurance that our intellectual property rights will be sufficient to distinguish our products and services from those of our competitors and to provide us with a competitive advantage. From time to time, third parties may use names and logos similar to ours, may apply to register trademarks or domain names similar to ours, and may infringe or otherwise violate our intellectual property rights. There can be no assurance that our intellectual property rights can be successfully asserted against such third parties or will not be invalidated, circumvented or challenged. Asserting or defending our intellectual property rights could be time consuming and costly and could distract management's attention and resources. If we are unable to prevent our competitors from using names, logos and domain names similar to ours, consumer confusion could result, the perception of our brand and products could be negatively affected, and our sales and profitability could suffer as a result. We also license the SPROUTS FARMERS MARKETS trademark to a third party for use in operating two grocery stores. If the licensee fails to maintain the quality of the goods and services used in connection with this trademark, our rights to, and the value of, this and similar trademarks could potentially be harmed. Negative publicity relating to the licensee could also be incorrectly associated with us, which could harm the business. Failure to protect our proprietary information could also have a material adverse effect on our business.

We may also be subject to claims that our activities or the products we sell infringe, misappropriate or otherwise violate the intellectual property rights of others. Any such claims can be time consuming and costly to defend and may distract management's attention and resources, even if the claims are without merit. Such claims may also require us to enter into costly settlement or license agreements (which could,

for example, prevent us from using our trademarks in certain geographies or in connection with certain products and services), pay costly damage awards, and face a temporary or permanent injunction prohibiting us from marketing or providing the affected products and services, any of which could have a material adverse effect on our business.

Changes in accounting standards may materially impact reporting of our financial condition and results of operations.

Accounting principles generally accepted in the United States and related accounting pronouncements, implementation guidelines, and interpretations for many aspects of our business, such as accounting for inventories, goodwill and intangible assets, store closures, leases, insurance, income taxes, stock-based compensation and accounting for mergers and acquisitions, are complex and involve subjective judgments. Changes in these rules or their interpretation may significantly change or add significant volatility to our reported earnings without a comparable underlying change in cash flow from operations. As a result, changes in accounting standards may materially impact our reported financial condition and results of operations.

Specifically, proposed changes to financial accounting standards could require such leases to be recognized on our balance sheet. In addition to our indebtedness, we have significant obligations relating to our current operating leases. All of our existing stores are subject to leases, which have average remaining terms of nine years and, as of January 3, 2016, we had undiscounted operating lease commitments of approximately \$1.3 billion, scheduled through 2032, related primarily to our stores, including stores that are not yet open. These commitments represent the minimum lease payments due under our operating leases, excluding common area maintenance, insurance and taxes related to our operating lease obligations, and do not reflect fair market value rent reset provisions in the leases. These leases are classified as operating leases and disclosed in Note 19 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K, but are not reflected as liabilities on our consolidated balance sheets. During fiscal 2015, our rent expense charged under operating leases was approximately \$88.1 million.

We incur substantial costs as a result of being a public company.

As a public company, we are subject to public company reporting obligations under the Exchange Act, and the rules and regulations regarding corporate governance practices, including those under the Sarbanes-Oxley Act of 2002 (referred to as the “Sarbanes-Oxley Act”), the Dodd-Frank Act of 2010, and the listing requirements of NASDAQ Global Select Market. We incur significant legal, accounting, and other expenses as a public company, including costs resulting from our public company reporting obligations and maintenance of corporate governance practices. Our management and other personnel devote a substantial amount of time to ensure that we comply with all of these requirements. The reporting requirements, rules, and regulations require substantial legal and financial compliance costs and will make some activities more time-consuming and costly than when we were a private company.

If we are unable to maintain effective internal control over financial reporting in the future, we may fail to prevent or detect material misstatements in our financial statements, in which case investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may decline.

As a public company, we are required to maintain internal control over financial reporting. Pursuant to Section 404 of the Sarbanes-Oxley Act, we are required to file a report by management on the effectiveness of our internal control over financial reporting, and our independent registered public accounting firm is required to attest to the effectiveness of our internal control over financial reporting.

In connection with management’s assessment of the effectiveness of our disclosure controls and procedures for Fiscal 2013, we concluded a material weakness existed related to our internal controls with respect to the costing of non-perishable inventories. During Fiscal 2014, we implemented additional

controls and procedures to address this material weakness and management determined that this material weakness was remediated as of December 28, 2014.

If we are unable to maintain effective internal control over financial reporting, if we identify any material weaknesses therein, if we are unsuccessful in our efforts to remediate any such material weakness, if our management is unable to report that our internal control over financial reporting is effective when required, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting when required, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected. In addition, we could become subject to investigations by NASDAQ Global Select Market, the SEC, or other regulatory authorities, which could require additional financial and management resources.

If our goodwill becomes impaired, we may be required to record a significant charge to earnings.

We have a significant amount of goodwill. As of January 3, 2016, we had goodwill of approximately \$368.1 million, which represented 26% of our total assets as of such date. Goodwill is reviewed for impairment on an annual basis in the fourth fiscal quarter or whenever events occur or circumstances change that would more likely than not reduce the fair value of our reporting unit below its carrying amount. Fair value is determined based on the discounted cash flows and comparable market values of our single reporting unit. If the fair value of the reporting unit is less than its carrying value, the fair value of the implied goodwill is calculated as the difference between the fair value of our reporting unit and the fair value of the underlying assets and liabilities, excluding goodwill. In the event an impairment to goodwill is identified, an immediate charge to earnings in an amount equal to the excess of the carrying value over the implied fair value would be recorded, which would adversely affect our operating results. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Estimates—Goodwill and Intangible Assets.”

Determining market values using a discounted cash flow method requires that we make significant estimates and assumptions, including long-term projections of cash flows, market conditions and appropriate market rates. Our judgments are based on historical experience, current market trends and other information. In estimating future cash flows, we rely on internally generated forecasts for operating profits and cash flows, including capital expenditures. Based on our annual impairment test during Fiscal 2013, 2014 and 2015, no goodwill impairment charge was required to be recorded. Changes in estimates of future cash flows caused by items such as unforeseen events or changes in market conditions could negatively affect our reporting unit’s fair value and result in an impairment charge. Factors that could cause us to change our estimates of future cash flows include a prolonged economic crisis, successful efforts by our competitors to gain market share in our core markets, our inability to compete effectively with other retailers or our inability to maintain price competitiveness. An impairment of a significant portion of our goodwill could materially adversely affect our financial condition and results of operations.

Our nutrition-oriented educational activities may be impacted by government regulation or our inability to secure adequate liability insurance.

We provide nutrition-oriented education to our customers, and these activities may be subject to state and federal regulation, and oversight by professional organizations. In the past, the FDA has expressed concerns regarding summarized health and nutrition-related information that (i) does not, in the FDA’s view, accurately present such information, (ii) diverts a consumer’s attention and focus from FDA-required nutrition labeling and information or (iii) impermissibly promotes drug-type disease-related benefits. If our team members or third parties we engage to provide this information do not act in accordance with regulatory requirements, we may become subject to penalties that could have a material adverse effect on our business. We believe we are currently in compliance with relevant regulatory requirements. However, we cannot predict the nature of future government regulation and oversight,

including the potential impact of any such regulation on this activity. Furthermore, the availability of professional liability insurance or the scope of such coverage may change, or our insurance coverage may prove inadequate, which may adversely impact the ability of our customer educators to provide some

information to our customers. The occurrence of any such developments could negatively impact the perception of our brand, our sales and our ability to attract new customers.

Common Stock Ownership Risks

Our stock price may be volatile, and you may not be able to resell your shares at or above the price you paid for them or at all.

There is no guarantee that our common stock will appreciate in value or even maintain the price at which our stockholders have purchased their shares. The trading price of our common stock may be volatile and subject to wide price fluctuations in response to various factors, many of which are beyond our control, including the following:

- actual or anticipated fluctuations in our quarterly or annual financial results;
- the financial guidance we may provide to the public, any changes in such guidance, or our failure to meet such guidance;
- failure of industry or securities analysts to maintain coverage of our company, changes in financial estimates by any industry or securities analysts that follow our company, or our failure to meet such estimates;
- various market factors or perceived market factors, including rumors, whether or not correct, involving us or our competitors;
- fluctuations in stock market prices and trading volumes of securities of similar companies;
- sales, or anticipated sales, of large blocks of our stock;
- short selling of our common stock by investors;
- additions or departures of key personnel;
- new store openings or entry into new markets by us or by our competitors;
- regulatory or political developments;
- changes in accounting principles or methodologies;
- litigation and governmental investigations;
- acquisitions by us or by our competitors; and
- general financial market conditions or events.

Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These and other factors may cause the market price and demand for our common stock to fluctuate substantially, which may limit or prevent investors from readily selling their shares of common stock and may otherwise negatively affect the price or liquidity of our common stock. In addition, in the past, when the market price of a stock has been volatile, holders of that stock have sometimes instituted securities class action litigation against the company that issued the stock. If any of our stockholders were to bring a lawsuit against us, we could incur substantial costs defending the lawsuit or paying for settlements or damages. Such a lawsuit could also divert the time and attention of our management from our business.

Anti-takeover provisions could impair a takeover attempt and adversely affect existing stockholders.

Certain provisions of our certificate of incorporation and bylaws and applicable provisions of Delaware law may have the effect of rendering more difficult, delaying, or preventing an acquisition of our company, even when this would be in the best interest of our stockholders. Our corporate governance documents include the following provisions:

- creating a classified board of directors whose members serve staggered three-year terms;
 - authorizing “blank check” preferred stock, which could be issued by our board of directors without stockholder approval and may contain voting, liquidation, dividend, and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- prohibiting our stockholders from acting by written consent, thereby requiring stockholder action to be taken at an annual or special meeting of stockholders;
- prohibiting our stockholders from calling special meetings of stockholders, which may delay the ability of our stockholders to force consideration of a proposal or the ability of holders controlling a majority of our capital stock to take any action, including the removal of directors;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- controlling the procedures for the conduct and scheduling of board and stockholder meetings;
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;
- permitting newly created directorships resulting from an increase in the authorized number of directors or vacancies on our board of directors to be filled only by a majority of our remaining directors, even if less than a quorum is then in office, or by a sole remaining director; and
- providing that our board of directors is expressly authorized to make, repeal, alter, or amend our bylaws.

In addition, Delaware law imposes conditions on the voting of “control shares” and on certain business combination transactions with “interested stockholders.”

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management. Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

If securities or industry analysts cease publishing research or reports about us, our business, or our market, or if they adversely change their recommendations regarding our stock, our stock price and trading volume could decline.

The trading market for our common stock is influenced by the research and reports that industry or securities analysts may publish about us, our business, our market or our competitors. If we do not maintain adequate research coverage, or if any of the analysts who may cover us downgrade our stock or publish inaccurate or unfavorable research about our business or provide relatively more favorable recommendations about our competitors, our stock price could decline. If any analyst who may cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Since we do not expect to pay any cash dividends for the foreseeable future, investors may be forced to sell their stock in order to obtain a return on their investment.

We do not anticipate declaring or paying in the foreseeable future any cash dividends on our capital stock. Instead, we plan to retain any earnings to finance our operations and growth plans. In addition, our Credit Facility contains covenants that would restrict our ability to pay cash dividends. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any return on their investment. As a result, investors seeking cash dividends should not purchase our common stock.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of January 3, 2016, we had 217 stores located in thirteen states, as shown in the chart below:

State	Number of Stores	State	Number of Stores
Alabama	3	Nevada	5
Arizona	29	New Mexico	7
California	82	Oklahoma	7
Colorado	27	Tennessee	2
Georgia	8	Texas	37
Kansas	3	Utah	5
Missouri	2		

In fiscal 2014, we opened 24 new stores, and in fiscal 2015 we opened 27 new stores. As of February 25, 2016, we have opened seven stores in fiscal 2016, bringing our total store count to 224.

We lease all of our stores from unaffiliated third parties. A typical store lease is for an initial 10 to 20 year term with four renewal options of five years each. We expect that we will be able to renegotiate these leases or relocate these stores as necessary. In addition to new store openings, we remodel or relocate stores periodically in order to improve performance. In fiscal 2015, we remodeled six stores and in fiscal 2016, we plan to remodel approximately six stores.

As of January 3, 2016, we leased our two distribution warehouses, as well as our current corporate office in Phoenix, Arizona, from unaffiliated third parties. Information about such facilities is set forth in the table below:

Facility	State	Square Footage*
Corporate Office	Arizona	71,000
Distribution Warehouse	Arizona	106,000
Distribution Warehouse	Texas	117,000

* Rounded to the nearest 1,000 square
feet

We believe our portfolio of long-term leases is a valuable asset supporting our retail operations, but we do not believe that any individual store property is material to our financial condition or results of operations.

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Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Market Information

Our common stock began trading on the NASDAQ Global Select Market under the symbol "SFM" on August 1, 2013. The price range per share of common stock presented below represents the highest and lowest closing prices for our common stock on the NASDAQ Global Select Market for each full quarterly period for fiscal years 2014 and 2015.

	High	Low
2014		
First quarter	\$40.09	\$33.92
Second quarter	\$38.35	\$25.73
Third quarter	\$33.18	\$29.10
Fourth quarter	\$32.94	\$27.17

	High	Low
2015		
First quarter	\$38.45	\$32.56
Second quarter	\$36.13	\$26.98
Third quarter	\$27.77	\$16.41
Fourth quarter	\$27.34	\$19.75

The closing price of our common stock as of February 24, 2016 was \$25.21 per share, and the number of stockholders of record of our common stock as of February 24, 2016 was 80. This number excludes stockholders whose stock is held in nominee or street name by brokers.

Dividend Policy

Since we became a publicly traded company on August 1, 2013, we have not declared or paid, and do not anticipate declaring or paying in the foreseeable future, any cash dividends on our capital stock. Any future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors and will depend on then existing conditions, including our operating results, financial condition, contractual restrictions, capital requirements, business prospects, and other factors our board of directors may deem relevant. Our Credit Facility contains covenants that would restrict our ability to pay cash dividends.

Issuer Purchases of Equity Securities

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

Period (1)	Total number	Average	Total number of	Approximate dollar
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	of shares purchased	price paid per share	shares purchased as part of publicly announced plans or programs (2)	value of shares that may yet be purchased under the plans or programs (2)
October 26, 2015 - November 29, 2015	761,606	\$ 24.04	761,606	\$ 131,690,992
November 30, 2015 - January 3, 2016	306,673	24.62	306,673	124,140,703
Total	1,068,279	\$ 24.31	1,068,279	

(1) Periodic information is presented by reference to our fiscal periods during the fourth quarter of fiscal year 2015.

(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.

Performance Graph

The graph set forth below compares the cumulative total stockholder return on our common stock between August 1, 2013 (the date our stock began trading on the Nasdaq Global Select Market) and January 3, 2016, with the cumulative total return of (i) the Nasdaq Composite Index and (ii) the S&P Food Retail Index, over the same period.

The comparison assumes that \$100.00 was invested in our common stock, the Nasdaq Composite Index and the S&P Food Retail Index, and assumes reinvestment of dividends, if any. The graph assumes the initial value of our common stock on August 1, 2013 was the closing sale price on that day of \$40.11 per share and not the initial offering price to the public of \$18.00 per share. The performance shown on the graph below is based on historical results and is not intended to suggest future performance.

This performance graph shall not be deemed “soliciting material” or to be “filed” with the SEC for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities under that section, and shall not be deemed to be incorporated by reference into any filing of Sprouts Farmers Market, Inc. under the Securities Act or the Exchange Act.

Item 6. Selected Financial Data

	Fiscal	Fiscal	Fiscal	Fiscal	Fiscal
	2015(5)	2014(4)	2013(3)	2012(2)	2011(1)
(dollars in thousands, except per share data)					
Statements of Operations Data:					
Net sales	\$3,593,031	\$2,967,424	\$2,437,911	\$1,794,823	\$1,105,879
Cost of sales, buying and occupancy	2,541,403	2,082,221	1,712,644	1,264,514	794,905
Gross profit	1,051,628	885,203	725,267	530,309	310,974
Direct store expenses	706,044	581,621	496,183	368,323	238,245
Selling, general and administrative expenses	106,412	95,397	81,795	86,364	58,528
Amortization of Henry's trade names and capitalized software	—	—	—	—	32,202
Store pre-opening costs	8,616	7,749	5,734	2,782	1,338
Store closure and exit costs	1,802	725	2,051	2,155	6,382
Income (loss) from operations	228,754	199,711	139,504	70,685	(25,721)
Interest expense	(17,723)	(25,063)	(37,203)	(35,488)	(19,813)
Other income	443	596	487	562	358
Loss on extinguishment of debt	(5,481)	(1,138)	(18,721)	(992)	—
Income (loss) before income taxes	205,993	174,106	84,067	34,767	(45,176)
Income tax (provision) benefit	(77,002)	(66,414)	(32,741)	(15,267)	17,731
Net income (loss)	\$128,991	\$107,692	\$51,326	\$19,500	\$(27,445)
Per Share Data:					
Net income (loss) per share—basic	\$0.84	\$0.72	\$0.38	\$0.16	\$(0.28)
Net income (loss) per share—diluted	\$0.83	\$0.70	\$0.37	\$0.16	\$(0.28)
Weighted average shares outstanding—					
basic	153,099	149,751	134,622	119,427	96,954
Weighted average shares outstanding—					
diluted	155,877	154,328	139,765	121,781	96,954

	Fiscal	Fiscal	Fiscal	Fiscal	Fiscal
	2015	2014	2013	2012(2)	2011(1)
Pro forma comparable store sales					
growth(6)	5.8	% 9.9	% 10.7	% 9.7	% 5.1
Pro forma stores at end of period	217	191	167	148	138
Other Operating Data:					
Stores at beginning of period	191	167	148	103	43

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Opened	27	24	19	9	7
Acquired	—	—	—	37	56
Closed	(1)	—	—	(1)	(3)
Stores at end of period(7)	217	191	167	148	103
Gross square feet at end of period	5,976,780	5,252,851	4,582,743	4,064,888	2,721,430
Average store size at end of period					
(gross square feet)	27,572	27,502	27,442	27,465	26,422

	As of January 3, 2016	December 28, 2014	December 29, 2013	December 30, 2012(2)	January 1, 2012(1)
Balance Sheet Data					
Cash and cash equivalents	\$ 136,069	\$ 130,513	\$ 77,652	\$ 67,211	\$ 14,542
Total assets	1,426,364	1,369,073	1,172,404	1,103,236	761,646
Total capital and finance lease obligations,					
including current portion	130,472	150,698	119,572	107,639	75,409
Total long-term debt, including current portion	160,000	256,357	311,240	426,544	294,764
Total stockholders' equity	822,992	685,389	513,771	386,755	267,453

- (1) The period from January 3, 2011 through April 18, 2011 reflects the sales and expenses directly attributable to Henry's operations and include allocations of expenses from Henry's previous parent company. These expenses were allocated to Henry's on the basis that was considered to reflect fairly or reasonably the utilization of the services provided to, or the benefit obtained by, Henry's. Historical financial statements for Henry's prior to April 18, 2011 do not reflect the interest expense or debt Henry's might have incurred if it had been a stand-alone entity. Additionally, we would have expected to incur other expenses not reflected in our historical financial statements prior to April 18, 2011, if Henry's had operated as a stand-alone entity. Commencing on April 18, 2011, our consolidated financial statements also include the financial position, results of operations and cash flows of the business we operated prior to the acquisition of Henry's (such prior business referred to as "Sprouts Arizona").
- (2) For the period from April 18, 2011 to May 28, 2012 our consolidated financial statements include the financial position results of operations and cash flows of Henry's and Sprouts Arizona. Commencing on May 29, 2012, our consolidated financial statements also include the financial position, results of operations and cash flows of Sunflower. Fiscal 2012 included \$19.5 million of expenses related to the acquisition and integration of Sunflower and Henry's.
- (3) Fiscal 2013 selling, general and administrative expense included \$3.2 million for IPO related bonuses and \$2.0 million for expenses related to our November 2013 secondary offering.
- (4) Fiscal 2014 selling, general and administrative expense included \$2.6 million for expenses related to our April 2014 secondary offering and our August 2014 secondary offering.
- (5) Fiscal 2015 includes 53 weeks.
- (6) Pro forma comparable store sales growth reflects comparable store sales growth calculated including stores acquired in the Transactions for all reported periods. 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 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 use pro forma comparable store sales to calculate pro forma comparable store sales growth.
- (7) During fiscal 2014, we also relocated one store.

Supplemental Pro Forma Data—Net Sales

Fiscal Fiscal Fiscal Fiscal Fiscal

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	2015	2014	2013	2012	2011	
	(dollars in thousands)					
Net sales—actual	\$3,593,031	\$2,967,424	\$2,437,911	\$1,794,823	\$1,105,879	
Pro forma adjustments(a)	—	—	—	196,140	616,776	
Pro forma net sales	\$3,593,031	\$2,967,424	\$2,437,911	\$1,990,963	\$1,722,655	
Pro forma comparable store sales						
growth(b)	5.8	% 9.9	% 10.7	% 9.7	% 5.1	%

(a) Pro forma adjustments reflect the net sales of Sprouts Arizona and Sunflower for all periods reported.

(b) Pro forma comparable store sales growth is calculated including all stores acquired in the Transactions for all periods reported.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations together with the consolidated financial statements and related notes that are included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors" or in other parts of this Annual Report on Form 10-K. Please also see the section entitled "Special Note Regarding Forward-Looking Statements."

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 217 stores in 13 states as of January 3, 2016, we are one of the largest specialty retailers of fresh, natural and organic food in the United States. As of February 24, 2016, we have grown to 224 stores in 13 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.

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.

Outlook

We are pursuing a number of strategies designed to continue our growth, including expansion of our store base, continuing positive comparable store sales 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. Although we plan to expand our store base primarily through new store openings, we may grow through strategic acquisitions if we identify suitable targets and are able to negotiate acceptable terms and conditions for acquisition. We intend to achieve 14% annual new store growth for at least the next five years, including 36 planned new store openings in 2016, of which seven have opened as February 24, 2016.

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.

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. Fiscal 2015 was a 53-week year ending on January 3, 2016. Fiscal 2014 and 2013 were 52-week years ending on December 28, 2014 and December 29, 2013, respectively. In the discussion below, we discuss the impact of the 53rd week of Fiscal 2015 on our financial results.

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 2015, we determined that we had sufficient data to estimate gift card breakage. We began recording an allowance for breakage on gift cards based on historical experience, and recorded \$0.7 million of gift card breakage related to prior period gift card sales. 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. Pro forma comparable store sales growth reflects comparable store sales growth on a pro forma basis calculated including all stores acquired in the Transactions. 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. This practice may differ from the methods that other retailers use to calculate similar measures. We use pro forma comparable store sales to calculate pro forma comparable store sales growth. See the table titled "Supplemental Pro Forma Data—Net Sales" in Item 6. Selected Financial Data.

Our net sales have increased as a result of new store openings and comparable store sales growth and the additional week in Fiscal 2015. Factors that influence comparable store sales growth and other sales trends include:

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

Cost of sales, buying and occupancy and gross profit

Cost of sales includes the cost of inventory sold during the period, including direct costs of purchased merchandise (net of discounts and allowances), distribution and supply chain costs, buying

costs and supplies. Merchandise incentives received from vendors are reflected in the carrying value of inventory when earned or as progress is made toward earning the rebate or allowance, and are reflected as a component of cost of sales as the inventory is sold. Inflation and deflation in the prices of food and other products we sell may periodically affect our gross profit and gross margin. The short-term impact of inflation and deflation is largely dependent on whether or not we pass the effects through to our customers, which will depend upon competitive market conditions.

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

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

Direct store expenses

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

Selling, general and administrative expenses

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

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

Store pre-opening costs

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

Store closure and exit costs

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

closure and exit costs in the consolidated statements of operations.

Provision for income taxes

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

Factors Affecting Comparability of Results of Operations

Additional Week in 2015

Fiscal 2015 consists of 53 weeks. The 53rd week resulted in additional sales and expenses as further discussed in “—Comparison of Fiscal 2015 to Fiscal 2014” below.

Adoption of Deferred Tax Asset Guidance

In Fiscal 2015, we adopted the guidance under Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) No. 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes”. ASU No. 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in our consolidated balance sheet. We elected to early adopt the guidance prospectively, and as such, did not restate prior periods to conform to the current presentation.

April 2015 Refinancing

In April 2015, we completed a transaction in which we refinanced our debt (referred to as the “April 2015 Refinancing”), as further discussed in “—Liquidity and Capital Resources” below. The April 2015 Refinancing resulted in an decrease in borrowings, a reduction in interest rate and the recording of a loss on extinguishment of debt.

April 2013 Refinancing

In April 2013, we completed a transaction in which we refinanced our debt (the “April 2013 Refinancing”) and made a distribution to our equity and option holders, as further discussed in “—Liquidity and Capital Resources” below. The April 2013 Refinancing resulted in an increase in borrowings, a reduction in interest rate and the recording of a loss on extinguishment of debt.

Corporate Conversion

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

IPO

On August 6, 2013, we completed our initial public offering of 21,275,000 shares of common stock of Sprouts Farmers Market, Inc., including 2,775,000 shares of common stock issued as a result of the exercise in full of the underwriters' option to purchase additional shares, at a price of \$18.00 per share.

We sold 20,477,215 shares of common stock, including the additional shares, and certain stockholders sold the remaining 797,785 shares.

We received net proceeds from our IPO of approximately \$344.1 million, after deducting underwriting discounts and offering expenses. We used the net proceeds to repay \$340.0 million of outstanding indebtedness under our former term loan and for general corporate purposes. We recorded a loss on extinguishment of debt related to the repayment.

Results of Operations for Fiscal 2015, 2014 and 2013

The following tables set forth our 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. Fiscal 2015 consisted of 53 weeks, while each of Fiscal 2014 and Fiscal 2013 consisted of 52 weeks.

	Fiscal 2015	Fiscal 2014	Fiscal 2013
	(in thousands)		
Consolidated Statement of Operations			
Data:			
Net sales	\$3,593,031	\$2,967,424	\$2,437,911
Cost of sales, buying and occupancy	2,541,403	2,082,221	1,712,644
Gross profit	1,051,628	885,203	725,267
Direct store expenses	706,044	581,621	496,183
Selling, general and administrative expenses	106,412	95,397	81,795
Store pre-opening costs	8,616	7,749	5,734
Store closure and exit costs	1,802	725	2,051
Income from operations	228,754	199,711	139,504
Interest expense	(17,723)	(25,063)	(37,203)
Other income	443	596	487
Loss on extinguishment of debt	(5,481)	(1,138)	(18,721)
Income before income taxes	205,993	174,106	84,067
Income tax provision	(77,002)	(66,414)	(32,741)
Net income	\$128,991	\$107,692	\$51,326

	Fiscal 2015	Fiscal 2014	Fiscal 2013
Other Operating Data:			
Pro forma comparable store sales growth	5.8 %	9.9 %	10.7 %
Stores at beginning of period	191	167	148
Opened	27	24	19
Acquired	—	—	—
Closed	(1)	—	—
Stores at end of period	217	191	167

* Presented on a comparable 52 week basis.

Comparison of Fiscal 2015 to Fiscal 2014

Net sales

	Fiscal 2015	Fiscal 2014	Change	% Change
	(dollars in thousands)			
Net sales	\$3,593,031	\$2,967,424	\$625,607	21 %
Comparable store sales growth	5.8	% 9.9	%	

Net sales increased during 2015 as compared to 2014, primarily as a result of (i) sales growth at stores operated prior to 2015, (ii) new store openings and (iii) the 53rd week included in 2015.

Net sales growth at stores operated prior to December 28, 2014 contributed \$376.2 million, or 60% of the increase in net sales for 2015. New store openings during 2015 contributed \$249.4 million, or 40%, of the increase in net sales during 2014. Included in those increases were a total of \$68.1 million of net sales attributable to the 53rd week in 2015.

Cost of sales, buying and occupancy and gross profit

	Fiscal 2015	Fiscal 2014	Change	% Change
	(dollars in thousands)			
Net sales	\$3,593,031	\$2,967,424	\$625,607	21 %
Cost of sales, buying and occupancy	2,541,403	2,082,221	459,182	22 %
Gross profit	1,051,628	885,203	166,425	19 %
Gross margin	29.3	% 29.8	% (0.5)%

Cost of sales, buying and occupancy increased during 2015 compared to 2014, primarily due to the increase in sales from comparable store sales growth, new store openings and the 53rd week in 2015. Gross profit increased \$186.6 million as a result of increased sales volume, offset by a decrease of \$20.2 million related to decreased margin. The gross margin decrease was primarily driven by continued price investments in certain categories and produce tightness due to adverse weather conditions and West Coast port strikes that limited product availability, compared to a very strong produce season in the prior year. The impact of the 53rd week on gross margin was insignificant.

Direct store expenses

	Fiscal 2015	Fiscal 2014	Change	% Change
	(dollars in thousands)			
Direct store expenses	\$706,044	\$581,621	\$124,423	21 %
Percentage of net sales	19.7	% 19.6	% 0.1	%

Direct store expenses increased \$124.4 million, due to a \$64.1 million increase in direct store expenses associated with stores operated prior to 2015 and \$60.3 million of direct store expenses related to stores opened during 2015. Included in that increase was approximately \$12.7 million of direct store expenses attributable to the 53rd week in 2015. Direct store expenses, as a percentage of net sales, was relatively flat year over year. Lower bonus expense was offset by increased training and by higher payroll costs due to an extra holiday in the year. The impact of the 53rd week on direct store expenses was insignificant.

Selling, general and administrative expenses

	Fiscal 2015	Fiscal 2014	Change	% Change
	(dollars in thousands)			
Selling, general and administrative expenses	\$ 106,412	\$ 95,397	\$ 11,015	12 %
Percentage of net sales	3.0 %	3.2 %	(0.2)%	

The increase in selling, general and administrative expenses included \$5.9 million for advertising expense to support growth into new markets, \$4.0 million for corporate payroll to support growth and internalize outsourced functions, \$2.4 million of increased share-based compensation expense related to changes in the executive team, \$1.8 million for regional payroll and benefits to support additional store count and growth into new regions, \$0.7 million for regional expenses to support growth and \$1.6 million increase in depreciation and occupancy expense for our new corporate headquarters. In addition, selling, general and administrative expenses were impacted by the 53rd week of 2015 by approximately \$0.6 million. These increases were partially offset by \$2.2 million less in offering expenses in current year, a \$1.9 million decrease in bonus expense due to lower expected attainment and current year benefit from lower than expected actual payments for the prior fiscal year and a \$1.6 million decrease in expense related to internalizing outsourced functions. Selling, general and administrative expenses decreased as a percent of net sales primarily driven by lower bonus expense in 2015. The impact of the 53rd week on selling, general and administrative expenses was insignificant.

Store pre-opening costs

Store pre-opening costs were \$8.6 million for 2015 and \$7.7 million for 2014. Store pre-opening costs during 2015 included \$7.2 million related to opening 27 stores during that period and \$1.4 million associated with stores opening after 2015. Store pre-opening costs during 2014 included \$7.0 million related to opening 24 stores and relocating one store during that period and \$0.7 million associated with stores opening after 2014.

Store closure and exit costs

Store closure and exit costs for 2015 included \$1.1 million for the relocation of our support office and adjustments for prior reserves. Store closure and exit costs for 2014 included costs related to the relocation of one store and a \$1.2 million favorable adjustment to reserves for settlement with landlord, offset by changes in reserves for stores and facilities already closed and ongoing expenses related to prior closures. Additionally, we determined that we should have been recording accretion expense for store closure reserves and made a correcting entry of \$0.9 million to adjust the liability for closed stores to include such accretion for prior periods. Such accretion was not material to any prior period.

Loss on extinguishment of debt

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

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

Interest expense

Interest expense decreased to \$17.7 million for 2015 from \$25.1 million for 2014. The decrease in interest expense is due to the lower principal balances on both the current Credit Facility and 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 \$77.0 million for 2015 from \$66.4 million for 2014, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 37.4% in 2015 from 38.1% in 2014 primarily due to an increase in tax credits and the enhanced charitable food contribution deduction.

Net income

	Fiscal 2015	Fiscal 2014	Change	% Change
	(dollars in thousands)			
Net income	\$ 128,991	\$ 107,692	\$ 21,299	20 %
Percentage of sales	3.6 %	3.6 %	—	

Net income growth was attributable to strong business performance driven by comparable store sales, strong performance of new stores opened, change in loss on extinguishment of debt, reduced interest expense and lower effective tax rate. Net income growth included the benefit of the 53rd week in 2015.

Comparison of Fiscal 2014 to Fiscal 2013

Net sales

	Fiscal 2014	Fiscal 2013	Change	% Change
	(dollars in thousands)			
Net sales	\$2,967,424	\$2,437,911	\$529,513	22 %
Comparable store sales growth	9.9	% 10.7	%	

Net sales increased during 2014 as compared to 2013, primarily as a result of (i) sales growth at stores operated prior to 2014 and (iii) new store openings.

Net sales growth at stores operated prior to December 29, 2013 contributed \$343.0 million, or 65% of the increase in net sales for 2014. New store openings during 2014 contributed \$186.5 million, or 35%, of the increase in net sales during 2014.

Cost of sales, buying and occupancy and gross profit

	Fiscal 2014	Fiscal 2013	Change	% Change
	(dollars in thousands)			
Net sales	\$2,967,424	\$2,437,911	\$529,513	22 %
Cost of sales, buying and occupancy	2,082,221	1,712,644	369,577	22 %
Gross profit	885,203	725,267	159,936	22 %
Gross margin	29.8	% 29.7	% 0.1	%

Cost of sales, buying and occupancy increased during 2014 compared to 2013, primarily due to the increase in sales from new store openings and comparable store sales growth, as discussed above. Gross profit increased \$157.0 million as a result of increased sales volume and \$2.9 million as a result of increased margin. The 10 basis point increase in gross margin during 2014 was primarily driven by leverage in occupancy, utilities and buying costs partially offset by lower merchandise margins from higher inflation in certain categories and increased promotional activities.

Direct store expenses

	Fiscal 2014	Fiscal 2013	Change	% Change
	(dollars in thousands)			
Direct store expenses	\$581,621	\$496,183	\$85,438	17 %
Percentage of net sales	19.6	% 20.4	% (0.8)	%

Direct store expenses increased \$85.4 million, primarily due to a \$43.2 million increase for stores operated prior to 2014. The remaining \$42.2 million increase in direct store expenses is associated with stores opened during 2014.

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Direct store expenses, as a percentage of net sales, decreased 80 basis points, primarily due to leverage in payroll, lower utilization of medical benefits, leverage in depreciation and store level expenses.

Selling, general and administrative expenses

	Fiscal 2014	Fiscal 2013	Change	% Change
(dollars in thousands)				
Selling, general and administrative				
expenses	\$95,397	\$ 81,795	\$13,602	17 %
Percentage of net sales	3.2 %	3.4 %	(0.2)%	

The increase in selling, general and administrative expenses included \$4.6 million of advertising expense due to additional new stores and new markets, \$4.2 million of corporate payroll and benefits to support growth, \$2.6 million of corporate bonus due to goal attainment, \$1.8 million of regional expenses due to increased store count and expansion into new regions, \$1.3 million increase in IT maintenance due to growth, \$0.9 million increase in depreciation primarily due to accelerated depreciation for corporate office move, \$0.5 million increase in secondary offering expenses including related payroll taxes and other less significant increases. These increases were partially offset by a \$3.2 million IPO bonus expense in the prior year, a \$1.4 million decrease in accounting fees related to the insourcing of certain functions, and \$1.1 million decrease in share based compensation expense due to vesting of historical grants. Selling, general and administrative expenses decreased as a percentage of net sales due to leverage in corporate expenses.

Store pre-opening costs

Store pre-opening costs were \$7.7 million for 2014 and \$5.7 million for 2013. Store pre-opening costs during 2014 included \$7.0 million related to opening 24 stores and relocating one store during that period and \$0.7 million associated with stores opening after 2014. Store pre-opening costs in 2013 included \$5.3 million related to opening 19 stores during that period and \$0.4 million for stores opened after 2013.

Store closure and exit costs

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

Loss on extinguishment of debt

In 2014, we made a voluntary principal payment of \$50.0 million and wrote-off \$1.1 million of deferred financing costs and original issue discount related to that portion of our former term loan.

In 2013, we recorded a loss on extinguishment of debt totaling \$18.7 million primarily related to the write-off of deferred financing costs and issue discount. These write-offs included \$9.0 million related to the August 2013 pay down of debt using proceeds from our IPO, \$8.2 million related to the April 2013 refinancing and \$1.0 million related to the December 2013 additional principal payment of \$40.0 million. Additionally, loss on extinguishment of debt includes \$0.5 million related to the renewal of a financing lease.

Interest expense

Interest expense decreased to \$25.1 million for 2014 from \$37.2 million for 2013, primarily due to a reduction in the interest rates related to the April 2013 Refinancing, the August 2013 pay down on the Term Loan, the \$40.0 million voluntary principal payment in December 2013, the \$50.0 million voluntary principal payment made in August 2014 and the May 2013 payoff of four former senior subordinated notes. These decreases were partially offset by an increase in interest related to additional capital and financial leases. See Note 12 "Long-Term Debt" to our audited consolidated financial statements.

Income tax provision

Income tax provision increased to \$66.4 million for 2014 from \$32.7 million for 2013, primarily related to an increase in income before income taxes. Our effective income tax rate decreased to 38.1% in 2014 from 38.9% in 2013 due to an increase in the enhanced charitable food contribution.

Net income

	Fiscal 2014	Fiscal 2013	Change	% Change
	(dollars in thousands)			
Net income	\$ 107,692	\$ 51,326	\$ 56,366	110 %
Percentage of sales	3.6 %	2.1 %	1.5 %	

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

Quarterly Financial Data

The following table sets forth certain of our unaudited consolidated statements of operations data for each of the fiscal quarters in fiscal 2015 and fiscal 2014.

	Fiscal Quarter Ended							
	January 3, 2016*	September 27, 2015	June 28, 2015(1)	March 29, 2015	December 28, 2014	September 28, 2014(2)	June 29, 2014	March 30, 2014(3)
Net sales	\$930,303	\$ 903,069	\$902,153	\$ 857,506	\$ 734,593	\$ 766,415	\$743,810	\$722,606
Gross profit	\$268,739	\$ 261,457	\$263,639	\$ 257,793	\$ 211,248	\$ 226,048	\$224,048	\$223,859
Income from								
operations	\$47,734	\$ 54,400	\$60,046	\$ 66,574	\$ 32,813	\$ 49,656	\$55,573	\$ 61,669
Net income	\$28,216	\$ 31,986	\$31,322	\$ 37,467	\$ 17,743	\$ 26,065	\$30,151	\$33,733
Net income per								
share:								
Basic	\$0.18	\$ 0.21	\$0.20	\$ 0.25	\$ 0.12	\$ 0.17	\$0.20	\$0.23
Diluted	\$0.18	\$ 0.21	\$0.20	\$ 0.24	\$ 0.11	\$ 0.17	\$0.20	\$0.22

*The fiscal quarter ended January 3, 2016 consisted of fourteen weeks.

- (1) Period includes \$5.5 million of loss on extinguishment of debt related to our April 2015 Refinancing.
- (2) Period includes \$0.9 million of expense related to our August 2014 secondary offering and \$1.1 million of loss on extinguishment of debt related to the \$50.0 million additional principal payment made during the period.
- (3) Period includes \$1.4 million of pre-tax expense related to our April 2014 secondary offering, including payroll taxes on options exercises.

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:

	Fiscal 2015	Fiscal 2014	Fiscal 2013
Cash and cash equivalents at end of period	\$ 136,069	\$ 130,513	\$ 77,652
Cash provided by operating activities	\$ 239,898	\$ 181,218	\$ 160,588
Cash used in investing activities	\$(128,312)	\$(126,671)	\$(86,291)
Cash used in financing activities	\$(106,030)	\$(1,686)	\$(63,856)

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, remodels and maintenance capital expenditures, and debt service. In 2015, we generated \$239.9 million in operating cash flows and ended 2015 with \$136.1 million of cash and cash equivalents. 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 \$58.7 million to \$239.9 million for 2015 compared to \$181.2 million for 2014. The increase in 2015 includes the impact of stores opened since 2014 and the effect of the 53rd week. In addition to the increase in the number of stores we operate, we leveraged occupancy, buying, utilities and fixed direct store expenses with comparable store sales growth. We also experienced a decrease in interest expense due to reductions in balances from a payoff of our \$257.8 million former term loan and from the total of \$100.0 million principal payments on our current Credit Facility.

Net cash provided by operating activities increased \$20.6 million to \$181.2 million for 2014 compared to \$160.6 million for 2013. The increase in 2014 includes the impact of stores opened since 2013. In addition to the increase in the number of stores we operate, we leveraged occupancy, buying, utilities and fixed direct store expenses with comparable store sales growth. We also experienced a decrease in interest expense due to reductions in debt balances from a payoff made with IPO proceeds and other voluntary repayments and lower interest rate, including a 0.5% lower rate due to our IPO.

Investing Activities

Net cash used in investing activities was \$128.3 million for 2015 compared to \$126.7 million for 2014. The increase in cash used for investing activities is primarily related to the purchase of four leases from the bankruptcy auction for Haggen stores.

Net cash used in investing activities was \$126.7 million for 2014 compared to \$86.3 million for 2013. The increase in cash used for investing activities is primarily related to timing of payments on capital expenditures for new store openings, store remodels and maintenance capital expenditures.

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

We expect capital expenditures of approximately \$145 to \$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 \$106.0 million for 2015 compared to \$1.7 million for 2014. The increase in cash used in financing activities of \$104.3 million is related to an increase in the net paydown of debt of \$44.3 million, a \$27.3 million decrease of excess tax benefits from the exercise of stock options, \$25.7 million of stock repurchases, \$4.5 million decrease in proceeds from the exercise of stock options, and \$1.9 million of deferred financing costs paid in our April 2015 Refinancing.

Subsequent to January 3, 2016, we repurchased an additional 2,431,721 shares of our common stock for \$59.3 million.

Net cash used in financing activities was \$1.7 million for 2014 compared to cash used in financing activities of \$63.9 million for 2013. The decrease in cash used in financing activities of \$62.2 million is related to \$295.9 million of payments to stockholders and optionholders in 2013, a \$76.7 million decrease in payments on debt instruments, a \$29.4 million increase of excess tax benefits from the exercise of stock options and payments to optionholders, a \$7.2 million increase in proceeds from the exercise of stock options, a \$4.2 million payment of IPO costs in 2013 and a \$1.4 million payment of deferred financing costs in 2013. These decreases in cash used by financing activities were offset by \$348.5 million of proceeds from the issuance of shares in 2013 and a decrease of \$4.0 million in cash from landlords related to financing lease obligations.

Long-term Debt and Former Credit Facilities

See Note 12 “Long-Term Debt” of our audited consolidated financial statements for a description of our Credit Facility and our Former Credit Facility (as defined therein).

Contractual Obligations

The following table summarizes our contractual obligations as of January 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)				
\$450.0 million Credit Facility (1)	\$160,000	\$—	\$—	\$160,000	\$—
Interest payments on \$450 million Credit Facility (2)	13,638	3,175	6,349	4,114	—
Capital and financing lease obligations(3)	154,905	27,700	32,977	29,469	64,759
Operating lease obligations(3)	1,345,206	108,429	243,153	233,934	759,690
Purchase commitments(4)	236,544	122,741	107,813	5,990	—
Totals(5)	\$1,910,293	\$262,045	\$390,292	\$433,507	\$824,449

(1) 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. Following the closing of the Credit Facility and the

initial borrowing of \$260 million, we made a total of \$100 million of principal payments on the Credit Facility, which reduced our total outstanding debt to \$160.0 million at January 3, 2016. These payments are reflected as a reduction to the Credit Facility, in the “4-5 Years” column. See Note 12 “Long-Term Debt” to our audited consolidated financial statements contained elsewhere in this Annual Report on Form 10-K.

- (2) Represents estimated interest payments through maturity on our Credit Facility based on the outstanding amounts as of January 3, 2016 and based on LIBOR rates and commitment fees that we locked into from November 23, 2015 through February 23, 2016.
- (3) Represents estimated payments for capital and financing and operating lease obligations as of January 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, \$2.3 million for years one to three, \$1.3 million for years four to five, and \$1.3 million for the period beyond five years.

(4) Consists primarily of open purchase orders and commitments under noncancelable service and supply contracts as of January 3, 2016.

(5) As of January 3, 2016, we had recorded \$32.8 million of liabilities related to our self-insurance program.

Self-insurance liabilities are not included in the table above because the payments are not contractual in nature and the timing of the payments is uncertain.

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

We periodically make other commitments and become subject to other contractual obligations that we believe to be routine in nature and incidental to the operation of the business. Management believes that such routine commitments and contractual obligations do not have a material impact on our business, financial condition or results of operations.

Off-Balance Sheet Arrangements

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

Impact of Inflation

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

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 per store 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 2015, is generally more available in the first six months of our fiscal year due to the timing of peak growing seasons.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, cash flow and related disclosure of contingent assets and liabilities. Our estimates include, but are not limited to, those related to inventory, lease assumptions, self-insurance reserves, sublease assumptions for closed stores, goodwill and intangible assets,

impairment of long-lived assets, fair values of equity-based awards and income taxes. We base our estimates on historical experience and on various other

assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

We believe that of our significant accounting policies, which are described in Note 3 to the audited consolidated financial statements included in this Annual Report on Form 10-K, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, we believe these are the most critical to fully understand and evaluate our financial condition and results of operations.

Inventories

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

The Company’s non-perishable inventory is valued at the lower of cost or market using weighted averaging and other estimation techniques, the use of which approximates the FIFO method.

During 2015, we changed our store inventory count procedure with respect to non-perishable inventories and no longer count all inventory in every store at the end of the every quarter. Previously, we had counted all inventory at every store at or near the balance sheet date and therefore recorded no estimate for shrink as of December 28, 2014 and December 29, 2013. We now count non-perishable store inventories on a rotational basis and perishable store inventories at the end of every quarter. The change in timing necessitates making an estimate for non-perishable inventory shrink between the count date and the reporting date. Accordingly, the inventory balance in the accompanying Consolidated Balance Sheets includes a \$2.8 million inventory shrink reserve as of January 3, 2016.

Equity-Based Compensation

Grants of options to purchase our shares under the 2011 Option Plan have been for equity instruments exchanged for employee services. We account for equity-based compensation in accordance with Financial Accounting Standards Board Accounting Standard Codification Topic 718, Compensation—Stock Compensation (referred to as “ASC 718”). Compensation expense associated with equity incentive grants requires management judgment to calculate the estimated fair value of awards, which typically vest over multi-year periods and for which the ultimate amount of compensation is not known on the date of grant. Time vested options generally vest ratably over a period of 12 quarters (three years) and performance-based options vest over a period of three years based on financial performance targets for each year. In the event of a change in control as defined in the 2011 Option Plan, all options become immediately vested and exercisable.

Our board of directors has adopted, and our equity holders have approved, the 2013 Incentive Plan. The 2013 Incentive Plan became effective on July 31, 2013 and replaced the 2011 Option Plan (except with respect to outstanding options under the 2011 Option Plan). The 2013 Incentive Plan enables us to formulate and implement a compensation program that will attract, motivate and retain experienced, highly-qualified team members who will contribute to our financial success, and aligns the interests of our team members with those of our stockholders through the ability to grant a variety of stock-based and cash-based awards. The 2013 Incentive Plan serves as the umbrella plan for our stock-based and cash-based incentive compensation programs for our directors, officers and other team members.

Under the provisions of ASC 718, equity-based compensation expense is measured at the grant date, based on the fair value of the award. As required under this guidance, we estimate forfeitures for options granted which are not

expected to vest. Changes in these inputs and assumptions can materially affect the measurement of the estimated fair value of our equity-based compensation expense.

Valuation. We have used the Black-Scholes option pricing model to calculate the fair value of our equity-based compensation awards at grant date.

The Black-Scholes model requires the use of highly subjective and complex assumptions to determine the fair value of equity-based compensation awards, including the option's expected term and the price volatility of the underlying stock. Refer to Note 22 to our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K for further discussion of these inputs.

In addition to assumptions used in the Black-Scholes option pricing model, we must also estimate a forfeiture rate to calculate the equity-based compensation cost for our awards. Our forfeiture rate is based on an analysis of our actual forfeitures of grants made under the 2011 Option Plan and 2013 Incentive Plan. We routinely evaluate the appropriateness of the forfeiture rate based on actual forfeiture experience, analysis of team member turnover and expectations of future option exercise behavior.

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

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

Lease Assumptions

The most significant estimates used by management in accounting for leases and the impact of those estimates are as follows:

Expected lease term—Our expected lease term includes both contractual lease periods and cancelable option periods where failure to exercise such options would result in an economic penalty. The expected lease term is used in determining whether the lease is accounted for as an operating lease or a capital lease. The expected lease term is also used in determining the useful life of the related assets. An increase in the expected lease term will increase the probability that a lease will be considered a capital lease and will generally result in higher interest and depreciation expense for a leased property recorded on our balance sheets.

Incremental borrowing rate—The incremental borrowing rate is primarily used in determining whether the lease is accounted for as an operating lease or a capital lease. An increase in the incremental borrowing rate decreases the net present value of the minimum lease payments and reduces the probability that a lease will be considered a capital lease. For leases which are recorded on our balance sheets with a related capital lease, the incremental borrowing rate is also used in allocating our rental payments between interest expense and a reduction of the outstanding obligation.

Fair market value of the leased asset—The fair market value of leased retail property is generally estimated based on comparable market data provided by third-party sources and evaluated using the experience of our development staff. Fair market value is used in determining whether the lease is accounted for as an operating lease or a capital lease.

Accounting owner—With certain leases, we are involved in the construction of the building (or certain significant changes to an existing building) and we are considered owner of the building for accounting purposes. We capitalize the amount of the total project costs incurred during the construction period. At the completion of the construction project, we evaluate whether the transfer to the landlord

meets the requirements for sale-leaseback accounting treatment. A sale and leaseback of the asset is deemed to occur when construction of the asset is complete and the lease term begins and the relevant sale-leaseback accounting criteria are met. If we do not pass the criteria for sale-leaseback accounting, we record a financing lease asset, which is included with “Buildings” and a corresponding financing obligation in “Capital and financing lease obligations” in our Consolidated Balance Sheets. We allocate each lease payment between a reduction of the lease obligation and interest expense using the effective interest method.

Goodwill and Intangible Assets

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

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

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

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

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

No impairment of goodwill or indefinite-lived intangible assets was recorded during fiscal 2015, 2014 or 2013 because the fair value of those assets was substantially above carrying value.

Impairment of Long-Lived Assets

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

When assessing the recoverability of our long-lived assets, we make assumptions regarding estimated future cash flows from the use and eventual disposition of the asset groups. We base our estimates on historical experience and projections, and consider recent economic and competitive trends. In the event that our estimates or assumptions change in the future, we may be required to record a long-lived asset impairment charge. We did not record any impairment loss during fiscal 2015, 2014 or 2013.

Income Taxes

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

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

Self-Insurance Reserves

We use a combination of insurance and self-insurance programs to provide reserves for potential liabilities associated with general liability, workers' compensation and team member health benefits. Liabilities for self-insurance reserves are estimated through consideration of various factors, which include historical claims experience, demographic

factors, security factors and other actuarial assumptions. We believe our assumptions are reasonable, but the estimated reserves for these liabilities could be affected materially by future events or claims experiences that differ from historical trends and assumptions.

Closed Store Reserve

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

Recently Issued Accounting Pronouncements

See Note 3 to our accompanying audited consolidated financial statements contained elsewhere in this Annual Report on Form 10-K.

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 7A. Quantitative and Qualitative Disclosures about Market Risk Interest Rate Sensitivity

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 January 3, 2016, each hundred basis point change in LIBOR would result in a change in interest expense by \$1.6 million annually. See Note 12 to our accompanying audited consolidated financial statements contained elsewhere in this Annual Report on Form 10-K for details on our Credit Facility.

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 8. Financial Statements and Supplementary Data
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders of Sprouts Farmers Market, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Sprouts Farmers Market, Inc. and its subsidiaries at January 3, 2016 and December 28, 2014, and the results of their operations and their cash flows for each of the three years in the period ended January 3, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 3, 2016, based on criteria established in Internal Control - Integrated Framework (2013 Framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control Over Financial Reporting, appearing under Item 9A of this Form 10-K. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our audits (which were integrated audits in 2015 and 2014). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 17 to the consolidated financial statements, the Company changed the manner in which it classifies deferred taxes in 2015.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Phoenix, Arizona

February 25, 2016

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	January 3, 2016	December 28, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 136,069	\$ 130,513
Accounts receivable, net	20,424	14,091
Inventories	165,434	142,793
Prepaid expenses and other current assets	23,288	11,152
Deferred income tax asset	—	35,580
Total current assets	345,215	334,129
Property and equipment, net of accumulated depreciation	494,067	454,889
Intangible assets, net of accumulated amortization	198,601	194,176
Goodwill	368,078	368,078
Other assets	19,003	17,801
Deferred income tax asset	1,400	—
Total assets	\$ 1,426,364	\$ 1,369,073
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 134,480	\$ 112,877
Accrued salaries and benefits	30,717	29,687
Other accrued liabilities	50,253	41,394
Current portion of capital and financing lease obligations	14,972	29,136
Current portion of long-term debt	—	7,746
Total current liabilities	230,422	220,840
Long-term capital and financing lease obligations	115,500	121,562
Long-term debt	160,000	248,611
Other long-term liabilities	97,450	74,071
Deferred income tax liability	—	18,600
Total liabilities	603,372	683,684
Commitments and contingencies (Note 19)		
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,		
152,577,884 shares issued and outstanding, January 3, 2016;		
151,833,334 shares issued and outstanding, December 28, 2014	153	152

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Additional paid-in capital	577,393	543,048
Retained earnings	245,446	142,189
Total stockholders' equity	822,992	685,389
Total liabilities and stockholders' equity	\$1,426,364	\$1,369,073

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Year Ended		
	January 3, 2016	December 28, 2014	December 29, 2013
Net sales	\$3,593,031	\$ 2,967,424	\$ 2,437,911
Cost of sales, buying and occupancy	2,541,403	2,082,221	1,712,644
Gross profit	1,051,628	885,203	725,267
Direct store expenses	706,044	581,621	496,183
Selling, general and administrative expenses	106,412	95,397	81,795
Store pre-opening costs	8,616	7,749	5,734
Store closure and exit costs	1,802	725	2,051
Income from operations	228,754	199,711	139,504
Interest expense	(17,723)	(25,063)	(37,203)
Other income	443	596	487
Loss on extinguishment of debt	(5,481)	(1,138)	(18,721)
Income before income taxes	205,993	174,106	84,067
Income tax provision	(77,002)	(66,414)	(32,741)
Net income	\$ 128,991	\$ 107,692	\$ 51,326
Net income per share:			
Basic	\$0.84	\$ 0.72	\$ 0.38
Diluted	\$0.83	\$ 0.70	\$ 0.37
Weighted average shares outstanding:			
Basic	153,099	149,751	134,622
Diluted	155,877	154,328	139,765

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

				(Accumulated	
		Common	Additional Paid-in	Deficit) /	Total
	Shares	Stock	Capital	Retained	Stockholders'
				Earnings	Equity
Balances at December 30, 2012	125,956,721	126	395,480	(8,851)	386,755
Net income	—	—	—	51,326	51,326
Issuance of shares under option plans	1,194,999	1	3,820	—	3,821
Issuance of shares in IPO, net of issuance costs	20,477,215	20	344,304	—	344,324
Repurchase of shares	(12,375)	—	(113)	—	(113)
Dividend paid to stockholders	—	—	(274,051)	(7,978)	(282,029)
Antidilution payments made to option holders	—	—	(13,892)	—	(13,892)
Excess tax benefit for exercise of options	—	—	13,424	—	13,424
Tax benefit of antidilution payments made to optionholders	—	—	4,402	—	4,402
Tax effect of forfeiture of vested options in equity	—	—	(27)	—	(27)
Equity-based compensation	—	—	5,780	—	5,780
Balances at December 29, 2013	147,616,560	147	479,127	34,497	513,771
Net income	—	—	—	107,692	107,692
Issuance of shares under option plans	4,216,774	5	11,307	—	11,312
Excess tax benefit for exercise of options	—	—	47,261	—	47,261
Tax effect of forfeiture of vested options in equity	—	—	(2)	—	(2)
Equity-based compensation	—	—	5,355	—	5,355
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 stock	(1,068,279)	(1)	—	(25,734)	(25,735)
Excess tax benefit for exercise of options	—	—	20,009	—	20,009

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Equity-based compensation	—	—	8,018	—	8,018
Balances at January 3, 2016	152,577,884	\$ 153	\$577,393	\$ 245,446	\$ 822,992

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	Year Ended		
	January 3, 2016	December 28, 2014	December 29, 2013
Cash flows from operating activities			
Net income	\$ 128,991	\$ 107,692	\$ 51,326
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	69,169	60,362	47,217
Accretion of asset retirement obligation and closed store reserve	344	844	322
Amortization of financing fees and debt issuance costs	742	1,494	2,482
Loss on disposal of property and equipment	1,512	1,087	449
Gain on sale of intangible assets	—	(100)	(19)
Equity-based compensation	8,018	5,355	5,780
Non-cash loss on extinguishment of debt	5,481	1,138	18,513
Deferred income taxes	15,581	16,432	13,731
Changes in operating assets and liabilities:			
Accounts receivable	(5,622)	(4,424)	(1,521)
Inventories	(22,641)	(24,537)	(19,875)
Prepaid expenses and other current assets	(12,042)	(3,127)	(3,738)
Other assets	(481)	(5,157)	(4,114)
Accounts payable	19,387	(4,721)	31,996
Accrued salaries and benefits	1,030	7,400	890
Other accrued liabilities	7,395	8,426	5,397
Other long-term liabilities	23,034	13,054	11,752
Net cash provided by operating activities	239,898	181,218	160,588
Cash flows from investing activities			
Purchases of property and equipment	(125,313)	(127,065)	(87,463)
Proceeds from disposal of property and equipment	2,708	294	1,000
Proceeds from sale of intangible assets	—	100	172
Purchase of leasehold interests	(5,707)	—	—
Net cash used in investing activities	(128,312)	(126,671)	(86,291)
Cash flows from financing activities			
Proceeds from revolving credit facility	260,000	—	—
Payments on revolving credit facility	(100,000)	—	—
Borrowings on term loan, net of financing costs	—	—	688,127
Payments on term loan	(261,250)	(57,000)	(786,850)
Payments on Senior Subordinated Notes	—	—	(35,000)
Payments on capital lease obligations	(662)	(585)	(412)
Payments on financing lease obligations	(3,480)	(3,006)	(2,868)
Payment of deferred financing costs	(1,896)	—	(1,370)

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Payments of IPO costs	—	—	(4,212)
Cash from landlord related to financing lease obligations	419	577	4,581
Payment to stockholders and optionholders	—	—	(295,921)
Excess tax benefit for exercise of options and antidilution payment to optionholders	20,009	47,261	17,826
Proceeds from the issuance of shares	—	—	348,536
Proceeds from exercise of stock options	6,565	11,067	3,820
Repurchase of common stock	(25,735)	—	(113)
Net cash used in financing activities	(106,030)	(1,686)	(63,856)
Net increase in cash and cash equivalents	5,556	52,861	10,441
Cash and cash equivalents at beginning of the period	130,513	77,652	67,211
Cash and cash equivalents at the end of the period	\$ 136,069	\$ 130,513	\$ 77,652
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ 17,455	\$ 23,768	\$ 38,091
Cash paid for income taxes	40,656	8,250	1,276
Supplemental disclosure of non-cash investing and financing activities			
Property and equipment in accounts payable	\$ 16,196	\$ 13,993	\$ 7,873
Property acquired through capital and financing lease obligations	10,125	34,140	10,660

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Sprouts Farmers Market, Inc., a Delaware corporation is the parent company of Sprouts Farmers Markets Holdings, LLC (“Intermediate Holdings”) which, through its subsidiaries, operates as a healthy grocery store that offers fresh, natural and organic food that includes fresh produce, bulk foods, vitamins and supplements, grocery, meat and seafood, bakery, dairy, frozen foods, body care and natural household items catering to consumers’ growing interest in eating and living healthier. As of January 3, 2016, the Company operated 217 stores in Alabama, Arizona, California, Colorado, Georgia, Kansas, Missouri, New Mexico, Nevada, Oklahoma, Tennessee, Texas and Utah. For convenience, the “Company” is used to refer collectively to Sprouts Farmers Market, Inc. and, unless the context requires otherwise, its subsidiaries. The Company’s store operations are conducted by its subsidiaries.

Corporate Conversion

On July 29, 2013, Sprouts Farmers Markets, LLC, a Delaware limited liability company, converted into Sprouts Farmers Market, Inc., a Delaware corporation (the “Corporate Conversion”). As a result of the corporate conversion, the members holding interests in Class A and Class B units of Sprouts Farmers Markets, LLC became holders of common stock of Sprouts Farmers Market, Inc., and options to purchase Class B units of Sprouts Farmers Markets, LLC were converted to options to purchase shares of common stock of Sprouts Farmers Market, Inc. The conversion of units and options to purchase units was on an 11 for 1 basis. The Company refers to this transaction as the “Corporate Conversion.” All equity related disclosures, including share, per share, and option disclosures, reflect the effects of the Corporate Conversion, including the 11 for 1 exchange.

The purpose of the Corporate Conversion was to reorganize the corporate structure so that the top-tier entity in the corporate structure, the entity that offered common stock to the public in the Company’s initial public offering, is a corporation rather than a limited liability company and so that the existing investors would own the Company’s common stock rather than equity interests in a limited liability company.

Initial Public Offering

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

2. Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries in accordance with accounting principles generally accepted in the United States of America (“GAAP”). All material intercompany accounts and transactions have been eliminated in consolidation.

The Company has one reportable and one operating segment. The Company’s Chief Executive Officer is the Chief Operating Decision Maker (“CODM”). The CODM bears ultimate responsibility for, and is actively engaged in, the allocation of resources and the evaluation of the Company’s operating and financial results.

The Company categorizes its products as perishable and non-perishable. Perishable product categories include produce, meat and seafood, deli and bakery. Non-perishable product categories include grocery, vitamins and supplements, bulk items, dairy and dairy alternatives, frozen foods, beer and wine, and body care and natural household items. The following is a breakdown of the Company's perishable and non-perishable sales mix:

	2015	2014	2013
Perishables	50.8%	50.8%	50.1%
Non-Perishables	49.2%	49.2%	49.9%

All dollar amounts are in thousands, unless otherwise noted.

3. Significant Accounting Policies

Fiscal Years

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 2015 ended on January 3, 2016 and included 53-weeks. Fiscal years 2014 and 2013 ended on December 28, 2014 and December 29, 2013, respectively, and included 52-weeks. Fiscal years 2015, 2014, and 2013 are referred to as 2015, 2014, and 2013.

Significant Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. Such estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's critical accounting estimates included, but are not limited to: inventory valuations, lease assumptions, sublease assumptions for closed stores, self-insurance reserves, goodwill and intangible assets, impairment of long-lived assets, fair values of equity-based awards and income taxes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. The Company's cash and cash equivalents are maintained at financial institutions in the United States of America. Deposits in these financial institutions may, from time to time, exceed the Federal Deposit Insurance Corporation's federally insured limits. All credit and debit card transactions are also classified as cash and cash equivalents. The amounts due from banks for these transactions at each reporting date were as follows:

As Of
January 3, December 28,

	2016	2014
Due from banks for debit and credit card transactions	\$51,309	\$ 31,750

Accounts Receivable

Accounts receivable generally represent billings to vendors for earned rebates, advertising and other items and landlords for tenant allowances. When a specific account is determined uncollectible, the net recognized receivable is written off.

Inventories

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

The Company's non-perishable inventory is valued at the lower of cost or market using weighted averaging and other estimation techniques, the use of which approximates the FIFO method.

The Company believes that all inventories are saleable and no allowances or reserves for obsolescence were recorded as of January 3, 2016 and December 28, 2014. During 2015, the Company changed its store inventory count procedure with respect to non-perishable inventories and no longer counts all inventory in every store at the end of the every quarter. Previously, the Company had counted all inventory at every store at or near the balance sheet date and therefore recorded no estimate for shrink. The Company now counts non-perishable store inventories on a rotational basis and perishable store inventories at the end of every quarter. The change in timing necessitates making an estimate for non-perishable inventory shrink between the count date and the reporting date. Accordingly, the inventory balance in the accompanying Consolidated Balance Sheets include a \$2.8 million inventory shrink reserve as of January 3, 2016.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Expenditures for major additions and improvements to facilities are capitalized, while maintenance and repairs are charged to expense as incurred. When property is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the consolidated statements of operations. Depreciation expense, which includes the amortization of assets recorded under capital and financing leases, is computed using the straight-line method over the estimated useful lives of the individual assets. Leasehold improvements and assets under capital and financing leases are amortized over the shorter of the lease term to which they relate, or the estimated useful life of the asset. Terms of leases used in the determination of estimated useful lives may include renewal options if the exercise of the renewal option is determined to be reasonably assured.

The following table includes the estimated useful lives of certain of our asset classes:

Software and used equipment	3 years
Computer hardware	5 years
Furniture, fixtures and equipment	7 years
Leasehold improvements	up to 15 years
Buildings	40 years

Store development costs, which include costs associated with the selection and procurement of real estate sites, are also included in property and equipment. These costs are included in leasehold improvements and are amortized over the remaining lease term of the successful sites with which they are associated. Certain project costs, including general site selection costs that cannot be identified with a specific store location, are charged to direct store expenses in the accompanying consolidated statements of operations.

Asset Retirement Obligations

The Company's asset retirement obligations ("ARO") are related to the Company's commitment to return leased facilities to the landlord in an agreed-upon condition. This may require actions ranging from cleaning to removal of leasehold improvements. The obligation is recorded as a liability with an offsetting capital asset at the inception of the lease term based upon the estimated fair market value of costs to meet the commitment. The liability, included in other long-term liabilities in the consolidated balance

sheets, is accreted over time to the projected future value of the obligation. The ARO asset, included in property and equipment in the consolidated balance sheets, is depreciated using the same useful life as the related property.

A reconciliation of the ARO liability is as follows:

	As Of	
	January 31,	December 28,
	2016	2014
Beginning balance	\$2,952	\$ 2,575
Additions for new facilities	245	551
Accretion expense	169	136
Adjustments	(152)	(310)
Ending balance	\$3,214	\$ 2,952

Closed Store Reserve

The Company recognizes a reserve for future operating lease payments and other occupancy costs associated with facilities that are no longer being utilized in its current operations. The reserve is recorded based on the present value of the remaining noncancelable lease payments and estimates of other occupancy costs after the cease use date less an estimate of subtenant income. If subtenant income is expected to be higher than the lease payments, no accrual is recorded. Lease payments and other occupancy costs included in the closed store reserve are expected to be paid over the remaining terms of the respective leases. Adjustments to the closed store reserve relate primarily to changes in actual or estimated subtenant income and 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 the market, subleases or other lease updates. Adjustments in the closed store reserves are recorded in “store closure and exit costs” in the accompanying consolidated statements of operations.

Self-Insurance Reserves

The Company uses a combination of insurance and self-insurance programs to provide reserves for potential liabilities associated with general liability, workers’ compensation and team member health benefits. Liabilities for self-insurance reserves are estimated through consideration of various factors, which include historical claims experience, demographic factors, severity factors and other actuarial assumptions. Amounts expected to be recovered from insurance companies is included in the liability, with a corresponding amount recorded in accounts receivable.

Goodwill and Intangible Assets

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

Goodwill is evaluated for impairment on an annual basis on the first day of the fourth fiscal quarter or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company’s impairment evaluation of goodwill consists of a qualitative assessment to determine if it is more likely than not that the fair value of a

reporting unit is less than its carrying amount. If the Company's qualitative assessment indicates it is more likely than not that the estimated fair value of a reporting unit exceeds its carrying value, no further analysis is required and goodwill is not impaired. Otherwise, the Company follows a two-step quantitative goodwill impairment test to determine if goodwill is impaired. The first step of the quantitative goodwill impairment test compares the fair value of a reporting unit with its

carrying amount, including goodwill. If the fair value of the Company's reporting unit exceeds its carrying value, no further analysis or impairment of goodwill is required. If the carrying value of the Company's reporting unit exceeds its fair value, the fair value of the reporting unit would be allocated to the reporting unit's assets and liabilities based on the relative fair value, with goodwill written down to its implied fair value, if necessary.

Indefinite-lived assets are evaluated for impairment on an annual basis on the first day of the fourth fiscal quarter or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company's impairment evaluation for its indefinite-lived intangible assets consists of a qualitative assessment similar to that for goodwill. If the Company's qualitative assessment indicates it is more likely than not that the estimated fair value of an indefinite-lived intangible asset exceeds its carrying value, no further analysis is required and the asset is not impaired. Otherwise, the Company compares the estimated fair value of the asset to its carrying amount with an impairment loss recognized for the amount, if any, by which carrying value exceeds estimated fair value.

The Company can elect to bypass the qualitative assessments approach for goodwill and indefinite-lived intangible assets and proceed directly to the quantitative assessments for goodwill or any indefinite-lived intangible assets in any period.

The Company has determined its business consists of a single reporting unit. When applying the quantitative test, the Company determines the fair value of its reporting unit using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies.

The Company completed its goodwill and indefinite-lived intangible asset impairment evaluations as of the first day of the fourth quarter and concluded during 2015, 2014 and 2013 that there was no impairment. The Company also concluded that events and circumstances continued to support classifying its indefinite-lived intangible assets as such. See Note 7, "Intangible Assets" and Note 8, "Goodwill" for further discussion.

The trade name related to "Sunflower Farmers Market" meets the definition of a defensive intangible asset and is amortized on a straight line basis over an estimated useful life of 10 years from the date of its acquisition by the Company. Favorable and unfavorable leasehold interests are amortized on a straight-line basis over the lease term.

Impairment of Long-Lived Assets

The Company assesses its long-lived assets, including property and equipment and finite-lived intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. The Company groups and evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which independent identifiable cash flows are available. Factors which may indicate potential impairment include a significant underperformance relative to the historical or projected future operating results of the store or a significant negative industry or economic trend. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by that asset. If impairment is indicated, a loss is recognized for any excess of the carrying value over the estimated fair value of the asset group. The fair value is estimated based on the discounted future cash flows or comparable market values, if available. The Company did not record any impairment loss during 2015, 2014 and 2013.

Deferred Financing Costs

The Company capitalizes certain fees and costs incurred in connection with the issuance of debt. Deferred financing costs are amortized to interest expense over the term of the debt using the effective interest method. For the Credit Facility and Former Credit Facility (as defined in Note 12, "Long-Term

Debt”), deferred financing costs are amortized on a straight line basis over the term of the facility. Upon prepayment, redemption or conversion of debt, the Company accelerates the recognition of an appropriate amount of financing costs as loss on extinguishment of debt. The current and noncurrent portions of deferred financing costs are included in Prepaid expenses and other current assets and Other assets, respectively, in the accompanying consolidated balance sheets.

Operating Leases

The Company leases certain stores, warehouse facilities and administrative offices under operating leases.

Incentives received from lessors are deferred and recorded as a reduction of rental expense over the lease term using the straight-line method. The current portion of unamortized lease incentives is included in Other accrued liabilities and the noncurrent portion is included in Other long-term liabilities in the accompanying consolidated balance sheets.

Store lease agreements generally include rent abatements and rent escalation provisions and may include contingent rent provisions based on a percentage of sales in excess of specified levels. The Company recognizes escalations of minimum rents and/or abatements as deferred rent and amortizes these balances on a straight-line basis over the term of the lease.

For lease agreements that require the payment of contingent rents based on a percentage of sales above stipulated minimums, the Company begins accruing an estimate for contingent rent when it is determined that it is probable the specified levels of sales in excess of the stipulated minimums will be reached during the year. The Company expensed \$1.8 million, \$1.6 million and \$1.4 million for the years ended January 3, 2016, December 28, 2014 and December 29, 2013, respectively, for contingent rent.

Financing Lease Obligations

The Company has recorded financing lease obligations for 38 store building leases at both January 3, 2016 and December 28, 2014. In each case, the Company was deemed to be the owner during the construction period under lease accounting guidance. Further, each lease contains provisions indicating continuing involvement with the property at the end of the construction period, which include either an affiliate guaranty or contingent collateral. As a result, in accordance with applicable accounting guidance, buildings and related assets subject to the leases are reflected on the Company’s balance sheets and depreciated over their remaining useful lives. The present value of the lease payments associated with these buildings is recorded as financing lease obligations.

At January 3, 2016, the Company also recorded current financing lease obligations and related construction in progress for two stores under the lease accounting guidance noted above. However, the Company expects that there will be no continuing involvement provisions in effect at the end of the construction period and therefore will be able to remove the asset and the corresponding financing lease obligations at the end of the construction periods for the stores during 2016.

At December 28, 2014 the Company also recorded a current financing lease obligation and related construction in progress totaling \$25.0 million for one of its administrative facilities under the lease accounting guidance noted above. However, the Company concluded there were no continuing involvement provisions in effect at the end of the construction period and removed the asset and corresponding financing lease obligation at the end of the construction period in the first quarter of fiscal 2015.

Monthly lease payments are allocated between the land element of the lease (which is accounted for as an operating lease) and the financing obligation. The financing obligation is amortized using the effective interest method and the

interest rate is determined in accordance with the requirements of sale-leaseback accounting. Lease payments less the portion allocated to the land element of the lease and

that portion considered to be interest expense decrease the financing liability. At the end of the initial lease term, should the Company decide not to renew the lease, the net book value of the asset and the corresponding financing obligation would be reversed.

The outflows from the construction of the buildings are classified as investing activities, and the outflows associated with the financing obligations principal payments and inflows from the associated financing proceeds are classified as financing activities in the accompanying consolidated statements of cash flows.

Fair Value Measurements

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

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

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

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

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in the impairment analysis of goodwill, intangible assets, 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 our goodwill impairment evaluation as described above is based upon Level 3 inputs. Closed store reserves are recorded at net present value to approximate fair value which is classified as Level 3 in the hierarchy. The estimated fair value of the closed store reserve is calculated based on the present value of the remaining lease payments and other charges using a weighted average cost of capital, reduced by estimated sublease rentals. The weighted average cost of capital is 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 comparable open market transactions, the fair value of the long-term debt approximated carrying value as of January 3, 2016. Based on comparable open market transactions of the Former Term Loan (as defined in Note 12), the fair value of the long-term debt, including current maturities, approximated carrying value as of December 28, 2014. The Company's estimates of the fair value of long-term debt (including current maturities) were classified as Level 2 in the fair value hierarchy.

Equity-Based Compensation

The Company measures equity-based compensation cost at the grant date based on the fair value of the award and recognizes equity-based compensation cost as expense over the vesting period. As equity-based compensation expense recognized in the consolidated statements of operations is based on awards ultimately expected to vest, the amount of expense has been reduced for estimated forfeitures and trued up for actual forfeitures. The Company's forfeiture rate is estimated based on an analysis of our actual forfeitures of grants made under our 2011 Option Plan

and 2013 Incentive Plan. The actual forfeiture rate could differ from these estimates. The Company uses the Black-Scholes option-pricing model to determine the grant date fair value for each option grant. The Black-Scholes option-pricing model requires extensive use of subjective assumptions. See Note 22, "Equity-Based Compensation" for

a discussion of assumptions used in the calculation of fair values. Application of alternative assumptions could produce different estimates of the fair value of equity-based compensation and, consequently, the related amounts recognized in the accompanying consolidated statements of operations. The grant date fair value of restricted stock units (“RSUs”) and performance share awards (“PSAs”) is based on the closing price per share of the Company’s stock on the grant date. The Company recognizes compensation expense for time-based awards on a straight-line basis and for performance-based awards on the graded-vesting method over the vesting period of the awards.

Revenue Recognition

Revenue is recognized at the point of sale. Discounts provided to customers at the time of sale are recognized as a reduction in sales as the discounted products are sold. Sales taxes are not included in revenue. Proceeds from the sale of gift cards are recorded as a liability at the time of sale, and recognized as sales when they are redeemed by the customer. During 2015, the Company obtained sufficient historical redemption data for its gift card program to make a reasonable estimate of the ultimate redemption patterns and breakage rate. Accordingly, the Company recognized \$1.0 million of gift card breakage as a component of net sales in the accompanying consolidated statements of operations for 2015.

Cost of Sales, Buying and Occupancy

Cost of sales includes the cost of inventory sold during the period, including the direct costs of purchased merchandise (net of discounts and allowances), distribution and supply chain costs, buying costs and supplies. Occupancy costs include store rental, property taxes, utilities, common area maintenance, amortization of favorable or unfavorable leasehold interests and property insurance. The Company recognizes vendor allowances and merchandise volume related rebate allowances as a reduction of inventories during the period when earned and reflects the allowances as a component of cost of sales, buying and occupancy as the inventory is sold.

Our largest supplier accounted for approximately 24% and 23% of total purchases, expressed as a percentage of our cost of sales, buying and occupancy expense, during 2015 and 2014, respectively.

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 and 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, related equity-based compensation, advertising, acquisition-related costs and corporate overhead.

The Company charges third-parties to place advertisements in the Company’s in-store guide and newspaper circulars. The Company records rebates received from vendors in connection with cooperative advertising programs as a reduction to advertising costs when the allowance represents a reimbursement of a specific incremental and identifiable cost. Advertising costs are expensed as incurred. Advertising expense was as follows:

Year Ended
January 3, December 28, December 29,

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	2016	2014	2013
Advertising expense	\$46,815	\$ 39,763	\$ 34,075
Vendor rebates	(14,810)	(13,614)	(12,530)
Advertising expense, net of rebates	\$32,005	\$ 26,149	\$ 21,545

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.

Loss on Extinguishment of Debt

The Company recognizes loss on extinguishment of debt when debt is refinanced and the new debt is either with a new lender or lenders and/or the cash flows associated with the refinanced debt and the original debt differ by greater than 10 percent. The loss on extinguishment of debt represents the amounts of deferred financing costs and/or issue discount associated with the extinguished portion of the debt.

In 2015, the Company recorded a loss on extinguishment of debt totaling \$5.5 million related to the April 2015 Refinancing as defined in Note 12.

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

In 2013, the Company recorded a loss on extinguishment of debt totaling \$18.2 million primarily related to the write-off of deferred financing costs and issue discount. These write-offs included \$1.0 million related to a partial repayment of the Former Term Loan, \$9.0 million related to the August 2013 pay down of debt using proceeds from our IPO and \$8.2 million related to the April 2013 Refinancing as defined in Note 12. Additionally, loss on extinguishment of debt for 2013 includes \$0.5 million related to the renewal of a financing lease.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company's deferred tax assets are subject to periodic recoverability assessments. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that more likely than not will be realized. Realization of the deferred tax assets is principally dependent upon achievement of projected future taxable income offset by deferred tax liabilities. Changes in recognition or measurement are reflected in the period in which the judgment occurs.

The Company recognizes the effect of uncertain income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to unrecognized tax benefits as part of income tax expense.

Share Repurchases

The Company has elected to retire shares repurchased to date. Shares retired become part of the pool of authorized but unissued shares. The Company has elected to record purchase price of the retired shares in excess of par value directly as a reduction of retained earnings.

Net Income per Share

Basic net income per share is calculated by dividing net income by the weighted average number of shares outstanding during the fiscal period.

Diluted net income per share is based on the weighted average number of shares outstanding, plus, where applicable, shares that would have been outstanding related to dilutive options, PSAs and RSUs.

Comprehensive Income

Comprehensive income equals net income for all periods presented.

Recently Issued Accounting Pronouncements

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

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

In June 2014, the FASB issued ASU Update No. 2014-12, "Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could be Achieved after the Requisite Service Period." The standard requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. This guidance will be effective for the Company for its fiscal year 2017. The Company does not expect the adoption of this guidance will have a material impact on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." ASU No. 2014-15 requires management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. This guidance will be effective for the Company for its fiscal year 2016, with early adoption permitted. The Company does

not expect the adoption of this guidance to have a material effect on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.” ASU No. 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the corresponding debt liability. This guidance will be effective for the Company for its fiscal year 2016. Early adoption is permitted. The Company is currently evaluating the potential impact of this guidance.

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 will be effective for the Company for its fiscal year 2016. Early adoption is permitted. The amendment may be adopted either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. The Company is currently evaluating the potential impact of this guidance.

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 July 2015, the FASB issued ASU No. 2015-15, “Interest – Imputation of Interest: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Subtopic 835-30).” ASU No. 2015-15 provides additional guidance on the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. Early adoption is permitted. This guidance will be effective for the Company for its fiscal year 2016. The Company is currently evaluating the potential impact of this guidance.

In September 2015, the FASB issued ASU No. 2015-16, “Business Combinations: Simplifying the Accounting For Measurement Period Adjustments.” ASU No. 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. This guidance will be effective for the Company for its fiscal year 2016. The Company does not expect the adoption of this guidance to have a material effect on its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes.” ASU No. 2015-17 requires that deferred liabilities and assets be classified as noncurrent in the consolidated balance sheet. The guidance is effective prospectively or retrospectively for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company has early adopted the guidance prospectively for the fiscal year ended January 3, 2016 and it had a material impact on its consolidated financial statements. The Company has not retrospectively adjusted the prior periods presented.

4. Accounts Receivable

A summary of accounts receivable is as follows:

	As Of	
	January 3,	December 28,
	2016	2014
Vendor	\$11,649	\$ 8,246
Landlord receivable	4,143	1,993
Other	4,632	3,852
Total	\$20,424	\$ 14,091

As of January 3, 2016 and December 28, 2014, the Company had recorded an allowance of \$0.1 million and \$0.3 million, respectively, for certain receivables.

5. Prepaid Expenses and Other Current Assets

A summary of prepaid expenses and other current assets is as follows:

	As Of	
	January	December 28,
	3,	
	2016	2014
Prepaid expenses	16,974	4,769
Income tax receivable	\$5,852	\$ 6,015
Other current assets	462	368
Total	\$23,288	\$ 11,152

6. Property and Equipment

A summary of property and equipment, net is as follows:

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	As Of	
	January 3,	December 28,
	2016	2014
Buildings	\$115,925	\$ 115,925
Furniture, fixtures and equipment	317,015	246,830
Leasehold improvements	260,039	216,068
Construction in progress	38,627	58,719
Total property and equipment	731,606	637,542
Accumulated depreciation and amortization	(237,539)	(182,653)
Property and equipment, net	\$494,067	\$ 454,889

A summary of leased property and equipment under capital and financing lease obligations is as follows:

	As Of	
	January 3, December 28,	
	2016	2014
Capital Leases—Buildings		
Gross asset balance	\$11,338	\$ 11,338
Accumulated depreciation	(2,249)	(1,364)
Net	\$9,089	\$ 9,974
Capital Leases—Equipment		
Gross asset balance	218	498
Accumulated depreciation	(218)	(488)
Net	\$0	\$ 10
Financing Leases		
Gross asset balance	117,197	129,614
Accumulated depreciation	(11,819)	(9,012)
Net	\$105,378	\$ 120,602

Depreciation expense was \$69.1 million, \$60.5 million and \$47.2 million for 2015, 2014 and 2013, respectively.

7. Intangible Assets

A summary of the activity and balances in intangible assets is as follows:

	Balance at			Balance at
	December 29,			December 28,
	2013	Additions	Other(a)	2014
Gross Intangible Assets				
Indefinite-lived trade names	\$ 182,937	\$ —	\$ —	\$ 182,937
Indefinite-lived liquor licenses	2,023	—	—	2,023
Finite-lived trade names	1,800	—	—	1,800
Finite-lived leasehold interests	12,574	—	—	12,574
Total intangible assets	\$ 199,334	\$ —	\$ —	\$ 199,334
Accumulated Amortization				
Finite-lived trade names	\$ (285)	\$ (180)	\$ —	\$ (465)

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Finite-lived leasehold interests	(3,582)	(1,111)	—	(4,693)
Total accumulated amortization	\$ (3,867)	\$ (1,291)	\$ —	\$ (5,158)

	Balance at			Balance at
	December 28,			January 3,
	2014	Additions	Other	2016
Gross Intangible Assets				
Indefinite-lived trade names	\$ 182,937	\$ —	\$ —	\$ 182,937
Indefinite-lived liquor licenses	2,023	—	—	2,023
Finite-lived trade names	1,800	—	—	1,800
Finite-lived leasehold interests	12,574	5,726	—	18,300
Total intangible assets	\$ 199,334	\$ 5,726		