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Sprouts Farmers Market, Inc.
Form 10-Q
May 02, 2019
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2019

Commission File Number: 001-36029

Sprouts Farmers Market, Inc.

(Exact name of registrant as specified in its charter)

Delaware 32-0331600
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

5455 East High Street, Suite 111

Phoenix, Arizona 85054

(Address of principal executive offices and zip code)

(480) 814-8016

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Title of Each Class

Name of Each Exchange on Which Registered

Trading Symbol(s)

Common Stock, \$0.001 par value SFM

NASDAQ Global Select Market

As of April 29, 2019, the registrant had 117,955,991 shares of common stock, \$0.001 par value per share, outstanding.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” that involve substantial risks and uncertainties. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the “Exchange Act”), including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses, and plans and objectives of management. In some cases, you can identify forward-looking statements by terms such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “project,” “will,” “would,” “should,” “could,” “can,” “predict,” “potential,” “objective,” or the negative of these terms, and similar expressions intended to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and involve known risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievement to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled “Risk Factors” included in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K for the fiscal year ended December 30, 2018, and our other filings with the Securities and Exchange Commission. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

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

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	March 31, 2019	December 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$19,502	\$1,588
Accounts receivable, net	25,190	40,564
Inventories	257,866	264,366
Prepaid expenses and other current assets	30,644	27,323
Total current assets	333,202	333,841
Property and equipment, net of accumulated depreciation	694,183	766,429
Operating lease assets	1,024,349	—
Intangible assets, net of accumulated amortization	185,530	194,803
Goodwill	368,078	368,078
Other assets	11,254	12,463
Total assets	\$2,616,596	\$1,675,614
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	\$263,745	\$253,969
Accrued salaries and benefits	38,650	48,603
Current portion of capital and financing lease obligations	—	7,428
Current portion of operating lease liabilities	74,745	—
Current portion of finance lease liabilities	592	—
Total current liabilities	377,732	310,000
Long-term capital and financing lease obligations	—	119,642
Long-term operating lease liabilities	1,067,269	—
Long-term debt and finance lease liabilities	512,018	453,000
Other long-term liabilities	39,110	153,377
Deferred income tax liability	63,946	50,399
Total liabilities	2,060,075	1,086,418
Commitments and contingencies (Note 9)		
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,	120	124

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120,436,879 shares issued and outstanding, March 31, 2019;

124,975,691 shares issued and outstanding, December 30, 2018

Additional paid-in capital	661,254	657,140
Accumulated other comprehensive income (loss)	(1,482)	1,134
Accumulated deficit	(103,371)	(69,202)
Total stockholders' equity	556,521	589,196
Total liabilities and stockholders' equity	\$2,616,596	\$1,675,614

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Thirteen Weeks Ended	
	March 31,	April 1,
	2019	2018 (1)
Net sales	\$1,413,887	\$1,287,196
Cost of sales	929,538	842,587
Gross profit	484,349	444,609
Selling, general and administrative expenses	374,826	338,774
Depreciation and amortization (exclusive of depreciation included in cost of sales)	29,459	26,145
Store closure and other costs	508	10
Income from operations	79,556	79,680
Interest expense, net	(5,002)	(6,064)
Other income	—	207
Income before income taxes	74,554	73,823
Income tax provision	(18,162)	(7,199)
Net income	\$56,392	\$66,624
Net income per share:		
Basic	\$0.46	\$0.50
Diluted	\$0.46	\$0.50
Weighted average shares outstanding:		
Basic	123,258	132,423
Diluted	123,926	133,752

(1) Effective in the fourth quarter of fiscal year 2018, the Company made a voluntary change in accounting principle to change the classification of certain expenses on its consolidated statements of income. The change was applied retrospectively to all periods presented. See Note 2, "Summary of Significant Accounting Policies" for further information.

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(IN THOUSANDS)

	Thirteen Weeks Ended March 31,	
	2019	2018
Net income	\$56,392	\$66,624
Other comprehensive income, net of tax		
Unrealized gain/(loss) on cash flow hedging		
activities, net of income tax of (\$905) and \$1,148	(2,616)	3,320
Total other comprehensive income (loss)	\$(2,616)	3,320
Comprehensive income	\$53,776	\$69,944

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(UNAUDITED)

(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

Thirteen Weeks Ended March 31, 2019						
			(Accumulated	Accumulated		
			Deficit)	Other		Total
	Common	Paid In	Retained	Comprehensive		Stockholders'
	Shares	Stock	Capital	Earnings	Income (Loss)	Equity
Balances at December 30, 2018	124,581,190	\$ 124	\$ 657,140	\$ (69,202)	\$ 1,134	\$ 589,196
Net income	—	—	—	56,392	—	56,392
Other comprehensive (loss)	—	—	—	—	(2,616)	(2,616)
Issuance of shares under stock plans	549,212	1	1,664	—	—	1,665
Repurchase and retirement of common stock	(4,890,766)	(5)	—	(111,880)	—	(111,885)
Share-based compensation	—	—	2,450	—	—	2,450
Impact of adoption of ASC 842 related to leases	—	—	—	21,319	—	21,319
Balances at March 31, 2019	120,239,636	\$ 120	\$ 661,254	\$ (103,371)	\$ (1,482)	556,521

Thirteen Weeks Ended April 1, 2018						
			(Accumulated	Accumulated		
			Deficit)	Other		Total
	Common	Paid In	Retained	Comprehensive		Stockholders'
	Shares	Stock	Capital	Earnings	Income (Loss)	Equity
Balances at December 31, 2017	132,450,092	\$ 132	\$ 620,788	\$ 30,558	\$ (784)	\$ 650,694
Net income	—	—	—	66,624	—	66,624
Other comprehensive income	—	—	—	—	3,320	3,320
Issuance of shares under stock plans	2,292,511	2	6,875	—	—	6,877
Repurchase and retirement of common stock	(3,329,409)	(3)	—	(82,997)	—	(83,000)

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common stock						
Share-based compensation	—	—	3,968	—	—	3,968
Balances at April 1, 2018	131,413,194	\$ 131	\$ 631,631	\$ 14,185	\$ 2,536	\$ 648,483

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(IN THOUSANDS)

	Thirteen Weeks Ended	
	March 31,	April 1,
	2019	2018
Cash flows from operating activities		
Net income	\$56,392	\$66,624
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	30,073	26,889
Operating lease asset amortization	20,653	—
Store closure and other costs	710	—
Share-based compensation	2,450	3,968
Deferred income taxes	6,217	10,629
Other non-cash items	(30)	455
Changes in operating assets and liabilities:		
Accounts receivable	3,247	(1,957)
Inventories	6,500	(10,069)
Prepaid expenses and other current assets	(744)	(2,135)
Other assets	(1,086)	(1,070)
Accounts payable and other accrued liabilities	18,819	18,637
Accrued salaries and benefits	(9,634)	(11,995)
Operating lease liabilities	(20,632)	—
Other long-term liabilities	(330)	4,511
Cash flows from operating activities	112,605	104,487
Cash flows from investing activities		
Purchases of property and equipment	(30,142)	(44,158)
Cash flows used in investing activities	(30,142)	(44,158)
Cash flows from financing activities		
Proceeds from revolving credit facilities	89,734	40,000
Payments on revolving credit facilities	(42,734)	(20,000)
Payments on capital and financing lease obligations	—	(1,039)
Payments on finance lease liabilities	(186)	—
Payments of deferred financing costs	—	(2,131)
Cash from landlords related to capital and financing lease obligations	—	900
Repurchase of common stock	(111,885)	(83,000)
Proceeds from exercise of stock options	1,661	6,877
Other	(319)	(59)
Cash flows used in financing activities	(63,729)	(58,452)
Increase in cash, cash equivalents, and restricted cash	18,734	1,877
Cash, cash equivalents, and restricted cash at beginning of the period	2,248	19,479
Cash, cash equivalents, and restricted cash at the end of the period	\$20,982	\$21,356

Supplemental disclosure of cash flow information		
Cash paid for interest	\$5,046	\$6,080
Cash refunded for income taxes	(22)	—
Supplemental disclosure of non-cash investing and financing activities		
Property and equipment in accounts payable	\$28,617	\$25,068
Property acquired through capital and financing lease obligations (ASC 840)	n/a	5,019

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

Sprouts Farmers Market, Inc., a Delaware corporation, through its subsidiaries, operates healthy grocery stores that offer fresh, natural and organic food through a complete shopping experience that includes fresh produce, bulk foods, vitamins and supplements, packaged groceries, meat and seafood, deli, baked goods, dairy products, frozen foods, beer and wine, natural body care and household items catering to consumers' growing interest in health and wellness. The "Company" is used to refer collectively to Sprouts Farmers Market, Inc. and unless the context otherwise requires, its subsidiaries.

The accompanying unaudited consolidated financial statements include the accounts of the Company in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial statements and are in the form prescribed by the Securities and Exchange Commission in instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial position, results of operations and cash flows for the periods indicated. All material intercompany accounts and transactions have been eliminated in consolidation. Interim results are not necessarily indicative of results for any other interim period or for a full fiscal year. The information included in these consolidated financial statements and notes thereto should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included herein and Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto for the fiscal year ended December 30, 2018 ("fiscal year 2018") included in the Company's Annual Report on Form 10-K, filed on February 21, 2019.

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

The Company reports its results of operations on a 52- or 53-week fiscal calendar ending on the Sunday closest to December 31. The fiscal year ending December 29, 2019 ("fiscal year 2019") and fiscal year 2018 are 52-week years. The Company reports its results of operations on a 13-week quarter, except for 53-week fiscal years.

Certain reclassifications of amounts reported in prior periods have been made to conform with the current period presentation.

All dollar amounts are in thousands, unless otherwise noted.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

2. Summary of Significant Accounting Policies

Change in Accounting Principle

In the fourth quarter of fiscal year 2018, the Company made a voluntary change in its accounting policy for the classification of certain expenses. Historically, the Company has presented store occupancy costs and buying costs in cost of goods sold. Under the new policy, the Company is presenting these expenses within selling, general and administrative expenses ("SG&A"). In addition, the Company changed the classification of depreciation and amortization (exclusive of supply chain-related depreciation included in cost of sales) from direct store expenses ("DSE") and SG&A to a separate financial statement line item and combined DSE and store pre-opening costs into SG&A. These reclassifications had no impact on sales, income from operations, net income or earnings per share. In addition, there was no cumulative effect to retained earnings, equity, or net assets.

The Company made this voluntary change in accounting policy in order to better reflect the direct costs of acquiring products and making them available to its customers in cost of sales. Store occupancy costs and buying costs, which are largely sales and marketing driven, are more appropriately reflected in SG&A. The new presentation of operating expenses now largely disaggregates cash from non-cash operating expenses, which the Company believes provides better information to its financial statement users. The Company believes these changes are preferable because they enhance the comparability of its financial statements with those of many of its industry peers and align with how the Company internally manages and reviews costs and margin. These changes in presentation have been retrospectively applied to all prior periods. Refer to the table below for the impact to the thirteen weeks ended April 1, 2018, as currently presented:

	Thirteen Weeks Ended April 1, 2018		
	Change in		
	Accounting		
	Unadjusted	Principle	As Adjusted
Cost of sales	\$900,144	\$(57,557)	\$ 842,587
Gross profit	387,052	57,557	444,609
Direct store expenses	262,595	(262,595)	—
Selling, general and administrative			
expenses	41,447	297,327	338,774
Depreciation and amortization			
(exclusive of depreciation			
included in cost of sales)	—	26,145	26,145
Store pre-opening costs	3,320	(3,320)	—

Revenue Recognition

The Company does not have any material contract assets or receivables from contracts with customers, any revenue recognized in the current period from performance obligations satisfied in previous periods, or any remaining performance obligations as of the March 31, 2019. The Company had a net gift card liability balance of \$10.1 million as of March 31, 2019 and \$14.6 million as of December 30, 2018, of which \$5.3 million was recognized as revenue during the thirteen weeks ended March 31, 2019.

Restricted Cash

Restricted cash relates to defined benefit plan forfeitures as well as health and welfare restricted funds of approximately \$1.5 million, and is included in prepaid expenses and other current assets in the consolidated balance sheets.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases (ASC 842)." ASU No. 2016-02 requires lessees to recognize a right-of-use asset and corresponding lease liability for all leases with terms greater than twelve months. Recognition, measurement and presentation of expenses will depend on classification as a financing or operating lease.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The Company adopted the standard as of December 31, 2018, the first day of fiscal year 2019. The Company elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, permits companies not to reassess prior conclusions on lease identification, lease classification and initial direct costs. The Company did not elect the hindsight practical expedient.

The adoption of the standard resulted in the recognition of operating lease assets and liabilities of approximately \$1.0 billion and \$1.1 billion, respectively, as of December 31, 2018, including recognition of operating lease assets and liabilities for certain third party operated distribution center locations. Included in the measurement of the new lease assets and liabilities is the reclassification of balances historically recorded as deferred rent and unfavorable and favorable leasehold interests. Additionally, the Company recognized a cumulative effect adjustment, which increased retained earnings by \$21 million, net of tax. This adjustment was driven by the derecognition of approximately \$114 million of lease obligations and \$93 million of net assets related to leases that had been classified as financing lease obligations under the former failed-sale leaseback guidance, and are now classified as operating leases as of the transition date. This reclassification also results in the recognition of rent expense beginning December 31, 2018, which was previously reported as interest expense under the former failed sale-leaseback guidance. Lastly, the adoption of this standard resulted in a change in naming convention for leases classified historically as capital leases. These leases are now referred to as finance leases. The adoption of this standard did not have a material impact on the Company's liquidity or cash flows.

Refer to Note 5, "Leases", for additional information related to the Company's updated lease accounting policy.

Recently Issued Accounting Pronouncements Not Yet Adopted

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The amendments in this update eliminate the second step of the goodwill impairment test and provide that an entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. The guidance will be effective for the Company for its fiscal year 2020, with early adoption permitted. The Company does not expect this ASU to materially impact the Company's consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-14, "Compensation — Retirement Benefits — Defined Benefit Plans — General (Subtopic 715-20) — Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans." The amendments in this update remove disclosures that no longer are considered cost-beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. The guidance will be effective for the Company for its fiscal year 2020, with early adoption permitted. The Company does not expect this ASU to materially impact the Company's disclosures.

No other new accounting pronouncements issued or effective during the thirteen weeks ended March 31, 2019 had, or are expected to have, a material impact on the Company's consolidated financial statements.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

3. Fair Value Measurements

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

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

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

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

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in the valuation of derivative instruments, impairment analysis of goodwill, intangible assets and long-lived assets.

The following tables present the fair value hierarchy for the Company's financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2019 and December 30, 2018:

	Level 1	Level 2	Level 3	Total
March 31, 2019				
Long-term debt	\$ —	\$500,000	\$ —	\$500,000
Interest rate swap liability	—	2,436	—	2,436
Total liabilities	\$ —	\$502,436	\$ —	\$502,436
Interest rate swap asset	\$ —	\$446	\$ —	\$446
Total assets	\$ —	\$446	\$ —	\$446
December 30, 2018				
Long-term debt	\$ —	\$453,000	\$ —	\$453,000
Total liabilities	\$ —	\$453,000	\$ —	\$453,000
Interest rate swap asset	\$ —	\$1,522	\$ —	\$1,522
Total assets	\$ —	\$1,522	\$ —	\$1,522

The Company's interest rate swaps are considered Level 2 in the hierarchy and are valued using an income approach. Expected future cash flows are converted to a present value amount based on market expectations of the yield curve on floating interest rates, which is readily available on public markets.

The determination of fair values of certain tangible and intangible assets for purposes of the Company's 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.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Cash, cash equivalents, restricted cash, accounts receivable, prepaid expenses and other current assets, accounts payable and other accrued liabilities, and accrued salaries and benefits 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 March 31, 2019 and December 30, 2018.

4. Long-Term Debt and Finance Lease Liabilities

A summary of long-term debt and finance lease liabilities is as follows:

Facility	Maturity	Interest Rate	As of	
			March 31,	December 30,
			2019	2018
Senior secured debt				
\$700.0 million Credit Agreement	March 27, 2023	Variable	\$ 500,000	\$453,000
Finance lease liabilities (see Note 5)	Various	n/a	12,018	—
Long-term debt and finance lease liabilities			\$512,018	\$453,000

Senior Secured Revolving Credit Facility

March 2018 Refinancing

On March 27, 2018, the Company's subsidiary, Sprouts Farmers Markets Holdings, LLC ("Intermediate Holdings"), as borrower, entered into an amended and restated credit agreement (the "Amended and Restated Credit Agreement") to amend and restate the Company's existing senior secured credit facility, dated April 17, 2015 (the "Former Credit Facility"). The Amended and Restated Credit Agreement provides for a revolving credit facility with an initial aggregate commitment of \$700.0 million, an increase from \$450.0 million from the Former Credit Facility, which may be increased from time to time pursuant to an expansion feature set forth in the Amended and Restated Credit Agreement.

Concurrently with the closing of the Amended and Restated Credit Agreement, all commitments under the Former Credit Facility were terminated, resulting in a \$0.3 million loss on early extinguishment of debt, recorded in interest expense during the first quarter of fiscal year 2018. The loss was due to the write-off of a proportional amount of deferred financing costs associated with the Former Credit Facility as the result of certain banks exiting the Amended and Restated Credit Agreement in connection with the refinancing. No amounts were outstanding under the Former Credit Facility as of March 31, 2019.

The Company capitalized debt issuance costs of \$2.1 million related to the refinancing which combined with the remaining \$0.7 million debt issuance costs for the Former Credit Facility, are being amortized on a straight-line basis to interest expense over the five-year term of the Amended and Restated Credit Agreement.

The Amended and Restated Credit Agreement also provides for a letter of credit subfacility and a \$15.0 million swingline facility. Letters of credit issued under the Amended and Restated Credit Agreement reduce its borrowing capacity. Letters of credit totaling \$26.9 million have been issued as of March 31, 2019, primarily to support the Company's insurance programs.

On March 6, 2019, Intermediate Holdings entered into an amendment to the Amended and Restated Credit Agreement intended to align the treatment of certain lease accounting terms with the Company's adoption of ASC 842. This amendment had no impact on borrowing capacity, interest rate, or maturity.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Guarantees

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

Interest and Fees

Loans under the Amended and Restated Credit Agreement initially bear interest at LIBOR plus 1.50% per annum. The interest rate margins are subject to adjustment pursuant to a pricing grid based on the Company's total net leverage ratio, as set forth in the Amended and Restated Credit Agreement. Under the terms of the Amended and Restated Credit Agreement, the Company is obligated to pay a commitment fee on the available unused amount of the commitments between 0.15% to 0.30% per annum, also pursuant to a pricing grid based on the Company's total net leverage ratio.

The interest rate on approximately 50% of outstanding debt under the Amended and Restated Credit Agreement is fixed, reflecting the effects of floating to fixed interest rate swaps (see Note 12, "Derivative Financial Instruments").

Outstanding letters of credit under the Amended and Restated Credit Agreement are subject to a participation fee of 1.50% per annum and an issuance fee of 0.125% per annum.

Payments and Borrowings

The Amended and Restated Credit Agreement is scheduled to mature, and the commitments thereunder will terminate on March 27, 2023, subject to extensions as set forth therein.

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

During the thirteen weeks ended March 31, 2019 the Company borrowed an additional \$89.7 million primarily for share repurchases and made a total of \$42.7 million of principal payments; resulting in total outstanding debt under the Amended and Restated Credit Agreement of \$500.0 million as of March 31, 2019. During fiscal year 2018, the Company borrowed \$233.0 million to be used in connection with the Company's share repurchase programs (see Note 10, "Stockholders' Equity") and made a total of \$128.0 million of principal payments; resulting in total outstanding debt under the Amended and Restated Credit Agreement of \$453.0 million at December 30, 2018.

Covenants

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

- incur additional indebtedness;
- grant additional liens;
- enter into sale-leaseback transactions;
- make loans or investments;
- merge, consolidate or enter into acquisitions;
- pay dividends or distributions;
- enter into transactions with affiliates;

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SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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- enter into new lines of business;
- modify the terms of debt or other material agreements; and
- change its fiscal year.

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

In addition, the Amended and Restated Credit Agreement requires that the Company and its subsidiaries maintain a maximum total net leverage ratio not to exceed 3.25 to 1.00 and minimum interest coverage ratio not to be less than 1.75 to 1.00. Each of these covenants is tested on the last day of each fiscal quarter.

The Company was in compliance with all applicable covenants under the Amended and Restated Credit Agreement as of March 31, 2019.

Former Credit Facility

On April 17, 2015, Intermediate Holdings, as borrower, entered into the Former Credit Facility that provided for a revolving credit facility with an initial aggregate commitment of \$450.0 million, subject to an expansion feature set forth therein. The Former Credit Facility also provided for a letter of credit subfacility and a \$15.0 million swingline facility.

The Former Credit Facility was scheduled to mature, and the commitments thereunder were scheduled to terminate, on April 17, 2020.

Loans under the Former Credit Facility bore interest, at the Company's option, either at adjusted LIBOR plus 1.50% per annum, or a base rate plus 0.50% per annum. The interest rate margins were subject to adjustment pursuant to a pricing grid based on the Company's total gross leverage ratio, as defined in the Former Credit Facility. Under the terms of the Former Credit Facility, the Company was obligated to pay a commitment fee on the available unused amount of the commitments equal to 0.20% per annum.

5. Leases

The Company leases all stores, distribution centers, and administrative offices. The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease assets, current portion of operating lease liabilities and noncurrent portion of operating lease liabilities in the Company's fiscal year 2019 consolidated balance sheet. Finance leases are included in property, plant, equipment, net, current portion of finance lease liabilities, and long-term debt and finance lease liabilities in the Company's fiscal year 2019 consolidated balance sheet. Operating lease payments are charged on a straight-line basis to rent expense, a component of selling, general and administrative expenses, over the lease term and finance lease payments are charged to interest expense and depreciation and amortization expense using a debt model over the lease term.

The Company's lease assets represent a right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Lease assets and liabilities and the related rent expense are recognized at the lease commencement date (date on which the Company gains access to the property) based on the estimated present value of lease payments over the lease term, net of landlord allowances to be received. The Company accounts for the lease and non-lease components as a single lease component for all current classes of leases.

Most of the Company's lease agreements include variable payments related to pass-through costs for maintenance, taxes, and insurance. Additionally, some of the Company's lease agreements include rental payments based on a percentage of retail sales over contractual levels. These variable payments are not included in the measurement of the lease liability or asset and are expensed as incurred.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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As most of the Company's lease agreements do not provide an implicit rate, the Company uses an estimated incremental borrowing rate, which is derived from third-party information available at the lease commencement date, in determining the present value of lease payments. The rate used is for a secured borrowing of a similar term as the lease.

Most leases include one or more options to renew, with renewal terms that can extend the lease term from one to twenty years or more. The exercise of lease renewal options is at the Company's sole discretion. The lease term includes the initial contractual term as well as any options to extend the lease when it is reasonably certain that the Company will exercise that option. Leases with a term of 12 months or less ("short-term leases") are not recorded on the balance sheet. The Company does not currently have any material short-term leases. Additionally, the Company's lease agreements do not contain any residual value guarantees or material restrictive covenants.

The Company subleases certain real estate to third parties, which have all been classified as operating leases. The Company recognized sublease income on a straight-line basis.

ASC 842 Disclosures

Lease cost includes both the fixed and variable expenses recorded for leases. The components of lease cost for the thirteen weeks ended March 31, 2019 were as follows:

		Thirteen Weeks Ended March 31, 2019
Operating lease cost	Selling, general and administrative expenses (1)	\$43,224
Finance lease cost:		
Amortization of Property and Equipment	Depreciation and amortization	242
Interest on lease liabilities	Interest expense	255

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Variable lease cost	Selling, general and administrative expenses (1)	12,919
Sublease income	Selling, general and administrative expenses	(248)
Total net lease cost		\$56,392

(1) Supply chain-related amounts of \$2.1 million of total net lease cost are included in cost of sales.

Supplemental balance sheet information related to leases was as follows:

	Classification	As of March 31, 2019
Assets		
Operating	Operating lease assets	\$ 1,024,349
Finance	Property and equipment, net	10,909
Total lease assets		\$ 1,035,258
Liabilities		
Current		
Operating	Current portion of operating lease liabilities	\$74,745
Finance	Current portion of finance lease liabilities	592
Noncurrent		
Operating	Long-term operating lease liabilities	1,067,269
Finance	Long-term debt and finance lease liabilities	12,018
Total lease liabilities		\$ 1,154,624

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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	As of	
	March	
	31,	
	2019	
Weighted average remaining lease term (years)		
Operating leases	10.2	
Finance leases	11.4	
Weighted average discount rate		
Operating leases	7.8	%
Finance leases	8.1	%

Supplemental cash flow and other information related to leases was as follows:

	Thirteen Weeks Ended March 31, 2019
Cash paid for amounts included in measurement of lease liabilities:	
Operating cash flows for operating leases	\$36,256
Operating cash flows for finance leases	255
Lease assets obtained in exchange for lease liabilities:	
Finance leases	—
Operating leases	81,691

Maturities of lease liabilities:

	Operating Leases (1)	Finance Leases	Total
2019	\$112,791	\$1,180	\$113,971
2020	199,484	1,724	201,208
2021	181,231	1,591	182,822
2022	171,903	1,671	173,574
2023	148,394	1,556	149,950

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2024	148,416	1,734	150,150
Thereafter	729,691	10,466	740,157
Total lease payments	1,691,910	19,922	1,711,832
Less: Imputed interest	(549,896)	(7,312)	(557,208)
Total lease liabilities	1,142,014	12,610	1,154,624
Less: Current portion	(74,745)	(592)	(75,337)
Long-term lease liabilities	\$ 1,067,269	\$ 12,018	\$ 1,079,287

(1) Operating lease payment include \$84.5 million related to options to extend lease terms that are reasonably certain of being exercised and exclude \$119.5 million of legally binding minimum lease payments for leases executed but not yet commenced.

ASC 840 Disclosures related to periods prior to adoption of ASC 842:

Operating Lease Commitments

The Company's leases include stores, office and distribution centers. These leases had an average remaining lease term of approximately nine years as of December 30, 2018.

Rent expense in fiscal years 2018, 2017 and 2016 totaled \$137.5 million, \$120.5 million and \$104.8 million, respectively.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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Future minimum lease obligations for operating leases with initial terms in excess of one year at December 30, 2018 are as follows:

2019	\$ 167,595
2020	179,058
2021	178,722
2022	170,515
2023	155,173
Thereafter	893,274
Total payments	\$ 1,744,337

The Company has subtenant agreements under which it will receive rent as follows:

2019	\$ 1,544
2020	1,623
2021	1,384
2022	1,290
2023	1,190
Thereafter	3,158
Total subtenant rent	\$ 10,189

Capital and Financing Lease Commitments

The Company is committed under certain capital and financing leases for rental of buildings and equipment. These leases expire or become subject to renewal clauses at various dates from 2019 to 2034.

As of December 30, 2018, future minimum lease payments required by all capital and financing leases during the initial lease term are as follows:

Fiscal Year	Capital Leases	Financing Leases
2019	\$ 1,692	\$ 14,881
2020	1,591	14,865
2021	1,591	14,202
2022	1,662	12,538

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2023	1,697	10,944
Thereafter	12,202	35,269
Total	20,435	102,699
Plus balloon payment (financing leases)	—	93,629
Less amount representing interest	(7,655)	(84,227)
Net present value of capital and financing lease obligations	12,780	112,101
Less current portion	(683)	(4,556)
Total long-term	\$12,097	\$107,545

The table above does not include \$2.2 million of current financing lease obligations expected to pass sale-leaseback accounting during 2019. The final payment under the financing lease obligations is a non-cash payment which represents the conveyance of the property to the buyer-lessor at the end of the lease term, described as balloon payment in the table above.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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6. Closed Store Reserves and Other Costs

The Company reviews the operating performance of individual stores on a regular basis. No stores were closed during the first quarter of fiscal year 2019. During the fourth quarter of fiscal year 2018, the Company decided to close two stores, one in Alabama and one in Georgia, primarily due to store performance and geographic reasons. These two stores were subsequently closed in December 2018.

As a result, in the fourth quarter of fiscal year 2018 the Company recorded a \$3.4 million closed store reserve for future operating lease payments and other occupancy costs associated with these two stores that are no longer being utilized in the Company's 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.

The following is a summary of closed store reserve activity during the thirteen weeks ended March 31, 2019 and fiscal year 2018. Closed store reserves are included in accounts payable and other accrued liabilities and other-long term liabilities in the accompanying consolidated balance sheets.

	March 31, 2019	December 30, 2018
Beginning balance	\$4,907	\$ 811
Additions	—	3,428
Usage	(316)	(426)
Adjustments	(439)	1,094
Ending balance	\$4,152	\$ 4,907

7. Income Taxes

The Company's effective tax rate increased to 24.4% for the thirteen weeks ended March 31, 2019 from 9.8% for the thirteen weeks ended April 1, 2018 primarily due to a decrease in the recognition of excess tax benefits related to share-based payments in the income tax provision. Excess tax benefits associated with equity-based compensation are recognized as income tax expense or benefit in the statements of income. The tax effects of exercised or vested awards are treated as discrete items in the reporting period in which they occur. The income tax benefits resulting from excess

tax benefits of equity-based compensation were \$0.2 million and \$11.1 million for the thirteen weeks ended March 31, 2019 and April 1, 2018, respectively.

8. Related-Party Transactions

A member of the Company's board of directors is an investor in a company that is a supplier of coffee to the Company for resale. During the thirteen weeks ended March 31, 2019, there were no purchases from this supplier and \$2.3 million of purchases during the thirteen weeks ended April 1, 2018. As of March 31, 2019 and December 30, 2018, the Company had no accounts payable due to this vendor. Effective January 1, 2019, this director no longer held an ownership interest in the supplier.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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9. Commitments and Contingencies

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

Securities Action

On March 4, 2016, a complaint was filed in the Superior Court for the State of Arizona against the Company and certain of its directors and officers on behalf of a purported class of purchasers of shares of the Company's common stock in the Company's underwritten secondary public offering which closed on March 10, 2015 (the "March 2015 Offering"). The complaint purports to state claims under Sections 11, 12 and 15 of the Securities Act of 1933, as amended, based on an alleged failure by the Company to disclose adequate information about produce price deflation in the March 2015 Offering documents. The complaint seeks damages on behalf of the purported class in an unspecified amount, rescission, and an award of reasonable costs and attorneys' fees. After removal to federal court, the plaintiff sought remand, which the court granted in March 2017. On May 25, 2017, the Company filed a Motion to Dismiss in the Superior Court for the State of Arizona, which the court granted in part and denied in part by order entered August 30, 2017. On August 4, 2018, the Company reached an agreement in principle to settle these claims. The parties' settlement agreement was granted preliminary approval by the court on January 30, 2019, with a hearing for final approval scheduled for May 31, 2019. If approved by the court, the settlement will be funded from the Company's directors and officers liability insurance policy and will not have a material impact on the Company's consolidated financial statements.

10. Stockholders' Equity

Share Repurchases

The following table outlines the common stock share repurchase programs authorized by the Company's board of directors and the related repurchase activity and available authorization as of March 31, 2019.

		Amount	Cost of	Authorization
Effective date	Expiration date	authorized	repurchases	available
November 4, 2015	November 4, 2017	\$ 150,000	\$ 150,000	\$ —
September 6, 2016	December 31, 2017	\$ 250,000	\$ 250,000	\$ —
February 20, 2017	December 31, 2018	\$ 250,000	\$ 250,000	\$ —
February 20, 2018	December 31, 2019	\$ 350,000	\$ 243,592	\$ 106,408

The shares under the Company's repurchase programs may be purchased on a discretionary basis from time to time prior to the applicable expiration date, subject to general business and market conditions and other investment opportunities, through open market purchases, privately negotiated transactions, or other means, including through Rule 10b5-1 trading plans. The board's authorization of the share repurchase programs does not obligate the Company to acquire any particular amount of common stock, and the repurchase programs may be commenced, suspended, or discontinued at any time. The Company has used borrowings under its Former Credit Facility and Amended and Restated Credit Agreement to assist with the repurchase programs (see Note 4, "Long-Term Debt and Finance Lease Liabilities").

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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Share repurchase activity under the Company's repurchase programs for the periods indicated was as follows (total cost in thousands):

	Thirteen Weeks Ended	
	March 31,	April 1,
	2019	2018
Number of common shares acquired	4,890,766	3,329,409
Average price per common share acquired	\$22.88	\$24.93
Total cost of common shares acquired	\$111,885	\$83,000

Shares purchased under the Company's repurchase programs were subsequently retired.

11. Net Income Per Share

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

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

	Thirteen Weeks Ended	
	March 31,	April 1,
	2019	2018
Basic net income per share:		
Net income	\$56,392	\$66,624
Weighted average shares outstanding	123,258	132,423
Basic net income per share	\$0.46	\$0.50
Diluted net income per share:		
Net income	\$56,392	\$66,624

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Weighted average shares outstanding - basic	123,258	132,423
Dilutive effect of share-based awards:		
Assumed exercise of options to purchase shares	152	807
RSUs	244	221
RSAs	91	160
PSAs	181	141
Weighted average shares and equivalent		
shares outstanding	123,926	133,752
Diluted net income per share	\$0.46	\$0.50

For the thirteen weeks ended March 31, 2019, the computation of diluted net income per share does not include 1.1 million options and 0.2 million PSAs as those awards would have been antidilutive or were performance awards with performance conditions not yet deemed met. For the thirteen weeks ended April 1, 2018, the computation of diluted net income per share does not include 1.1 million options and 0.1 million PSAs as those awards would have been antidilutive or were performance awards with performance conditions not yet deemed met.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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12. Derivative Financial Instruments

The Company entered into an interest rate swap agreement in December 2017 to manage its cash flow associated with variable interest rates. This forward contract has been designated and qualifies as a cash flow hedge, and its change in fair value is recorded as a component of other comprehensive income and reclassified into earnings in the same period or periods in which the forecasted transaction occurs. The forward contract consists of five cash flow hedges. To qualify as a hedge, the Company needs to formally document, designate and assess the effectiveness of the transactions that receive hedge accounting.

The notional dollar amount of the four outstanding swaps was \$250.0 million at March 31, 2019, under which the Company pays a fixed rate and receives a variable rate of interest (cash flow swap). The cash flow swaps hedge the change in interest rates on debt related to fluctuations in interest rates and each have a length of one year and mature annually from 2019 to 2022. These interest rate swaps have been designated and qualify as cash flow hedges and have met the requirements to assume zero ineffectiveness. The Company reviews the effectiveness of its hedging instruments on a quarterly basis.

The counterparties to these derivative financial instruments are major financial institutions. The Company evaluates the credit ratings of the financial institutions and believes that credit risk is at an acceptable level. The following table summarizes the fair value of the Company's derivative instruments designated as hedging instruments:

As of		As of	
March 31, 2019		December 30, 2018	
	Balance Sheet Location	Fair Value	Fair Value
Interest rate swaps	Other current assets	\$446	\$944
Interest rate swaps	Other long-term liabilities	2,436	578

The gain or loss on these derivative instruments is recognized in other comprehensive income, net of tax, with the portion related to current period interest payments reclassified to interest expense on the consolidated statements of income. The following table summarizes these gains and losses classified on the consolidated statements of income:

Thirteen
Weeks Ended

March April
31, 1,
2019 2018

Consolidated Statements of

Income Classification

Interest expense (income), net \$(213) \$ 132

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES

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13. Comprehensive Income

The following table presents the changes in accumulated other comprehensive income for the thirteen weeks ended March 31, 2019 and April 1, 2018.

	Cash Flow	Hedges
Balance at December 31, 2017		\$(784)
Other comprehensive income, net of tax		
Unrealized gain on cash flow hedging activities, net of		
income tax of \$1,148	3,320	
Total other comprehensive income	3,320	
Balance at April 1, 2018	\$2,536	
Balance at December 30, 2018		1,134
Other comprehensive income, net of tax		
Unrealized loss on cash flow hedging activities, net of		
income tax of (\$905)	(2,616)	
Total other comprehensive income	(2,616)	
Balance at March 31, 2019	\$(1,482)	

Amounts reclassified from accumulated other comprehensive income (loss) are included within interest expense on the consolidated statements of income.

14. Segments

The Company has one reportable and one operating segment, healthy grocery stores.

In accordance with Accounting Standards Codification 606, "Revenue from Contracts with Customers," the following table represents a disaggregation of revenue for the thirteen weeks ended March 31, 2019 and April 1, 2018.

	Thirteen Weeks Ended					
	March 31, 2019			April 1, 2018		
Perishables	\$807,051	57.1	%	\$732,602	56.9	%
Non-Perishables	606,836	42.9	%	554,594	43.1	%
Net Sales	\$1,413,887	100.0	%	\$1,287,196	100.0	%

The Company categorizes the varieties of products it sells as perishable and non-perishable. Perishable product categories include produce, meat, seafood, deli, bakery, floral and dairy and dairy alternatives. Non-perishable product categories include grocery, vitamins and supplements, bulk items, frozen foods, beer and wine, and natural health and body care.

15. Share-Based Compensation

2013 Incentive Plan

The Company's board of directors adopted, and its equity holders approved, the Sprouts Farmers Market, Inc. 2013 Incentive Plan (the "2013 Incentive Plan"). The 2013 Incentive Plan became effective July 31, 2013 in connection with the Company's initial public offering and replaced the 2011 Option Plan (as defined below) (except with respect to outstanding options under the 2011 Option Plan). The 2013 Incentive Plan serves as the umbrella plan for the Company's share-based and cash-based incentive compensation programs for its directors, officers and other team members. On May 1, 2015, the Company's stockholders approved the material terms of the performance goals under the 2013 Incentive Plan for purposes of Section 162(m) of the Internal Revenue Code.

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Awards Granted

During the thirteen weeks ended March 31, 2019, the Company granted the following share-based compensation awards, under the 2013 Incentive Plan:

Grant Date	RSUs	PSAs	Options
March 2019	386,115	95,768	53,866
Total	386,115	95,768	53,866
Weighted-average grant date fair value	\$23.12	\$23.12	\$7.63
Weighted-average exercise price	—	—	\$23.12

The aggregate number of shares of common stock that may be issued to team members and directors under the 2013 Incentive Plan may not exceed 10,089,072. Shares subject to awards granted under the 2013 Incentive Plan which are subsequently forfeited, expire unexercised or are otherwise not issued will not be treated as having been issued for purposes of the share limitation. As of March 31, 2019, there were 2,735,670 stock awards outstanding and 4,922,527 shares remaining available for issuance under the 2013 Incentive Plan.

2011 Option Plan

In May 2011, the Company adopted the Sprouts Farmers Markets, LLC Option Plan (the “2011 Option Plan”) to provide team members or directors of the Company with options to acquire shares of the Company. The Company had authorized 12,100,000 shares for issuance under the 2011 Option Plan. Options may no longer be issued under the 2011 Option Plan. As of March 31, 2019, there were 97,081 options outstanding under the 2011 Option Plan.

Stock Options

The Company uses the Black-Scholes option pricing model to estimate the fair value of options at grant date. Options vest in accordance with the terms set forth in the grant letter.

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

RSUs

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

PSAs

PSAs granted in fiscal year 2016 are restricted shares that were subject to the Company achieving certain earnings before interest and taxes (“EBIT”) performance targets on an annual and cumulative basis over a three-year performance period, as well as additional time-vesting conditions. The performance conditions with respect to the EBIT targets were deemed to not have been met, and all relevant PSAs have forfeited.

PSAs granted in March 2017 were subject to the Company achieving certain earnings per share performance targets during fiscal year 2017. The criteria was based on a range of performance targets in which grantees could earn between 10% and 150% of the base number of awards granted. The performance conditions with respect to fiscal year 2017 earnings per share were deemed to have been met, and the PSAs vested 50% on the second anniversary of the grant date (March 2019) and will vest 50% on the third anniversary of the grant date (March 2020). During the thirteen weeks ended March 31, 2019, 106,360 of the 2017 PSAs were vested.

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PSAs granted in March 2018 are subject to the Company achieving certain EBIT performance targets for the 2020 fiscal year. The criteria is based on a range of performance targets in which grantees may earn 0% to 200% of the base number of awards granted. If performance conditions are met, the applicable number of performance shares will vest on the third anniversary of the grant date (March 2021).

PSAs granted in March 2019 are subject to the Company achieving certain EBIT performance targets for the 2021 fiscal year. The criteria is based on a range of performance targets in which grantees may earn 0% to 200% of the base number of awards granted. If performance conditions are met, the applicable number of performance shares will vest on the third anniversary of the grant date (March 2022).

RSAs

The fair value of RSAs is based on the closing price of the Company's common stock on the grant date. Outstanding RSA grants vest annually over three years.

Share-based Compensation Expense

The Company presents share-based compensation expense in selling, general and administrative expenses on the Company's consolidated statements of income. The amount recognized was as follows:

	Thirteen Weeks Ended March 31, April 1,	
	2019	2018
Share-based compensation expense before		
income taxes	\$2,450	\$3,968
Income tax benefit	(576)	(1,020)
Net share-based compensation expense	\$1,874	\$2,948

The following share-based awards were outstanding as of March 31, 2019 and April 1, 2018:

As of

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	March 31,	April 1,
	2019	2018
	(in thousands)	
Options		
Vested	1,732	2,505
Unvested	95	233
RSUs	713	692
PSAs	223	380
RSAs	70	226

As of March 31, 2019, total unrecognized compensation expense and remaining weighted average recognition period related to outstanding share-based awards was as follows:

	Unrecognized compensation expense	Remaining weighted average recognition period
Options	\$ 686	2.8
RSUs	15,266	2.2
PSAs	3,322	2.1
RSAs	1,166	0.9
Total unrecognized compensation expense		
at March 31, 2019	\$ 20,440	

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During the thirteen weeks ended March 31, 2019 and April 1, 2018, the Company received \$1.7 million and \$6.9 million, respectively, in cash proceeds from the exercise of options.

16. Subsequent Events

Subsequent to March 31, 2019, and through April 29, 2019, the Company repurchased an additional 2.4 million shares of common stock for \$51.4 million.

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

You should read the following discussion of our financial condition and results of operations together with the consolidated financial statements and related notes that are included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K filed for the 2018 fiscal year, February 21, 2019 with the Securities and Exchange Commission. All dollar amounts included below are in thousands, unless otherwise noted.

Business Overview

Sprouts Farmers Market operates healthy grocery stores that specialize in fresh, natural and organic products at prices that appeal to everyday grocery shoppers. Based on the belief that healthy food should be affordable, Sprouts' welcoming environment and knowledgeable team members continue to drive its growth. Sprouts offers a complete shopping experience that includes an array of fresh produce in the heart of the store, a deli with prepared entrees and side dishes, The Butcher Shop, The Fish Market, an expansive vitamins and supplements department and more. Since our founding in 2002, we have grown rapidly, significantly increasing our sales, store count and profitability. With 321 stores in 19 states as of March 31, 2019, we are one of the largest specialty retailers of fresh, natural and organic food in the United States. As of April 29, 2019, we have grown to 322 stores in 19 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 Heritage

In 2002, we opened the first Sprouts Farmers Market store in Chandler, Arizona. From our founding in 2002 through March 31, 2019, we have continued to open new stores while successfully rebranding 43 Henry's Farmers Market and 39 Sunflower Farmers Market stores added in 2011 and 2012, respectively, through acquisitions to the Sprouts banner. 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 expect to open approximately 30 new stores per year for the near term, and in 2019, we have opened 9 new stores through April 29, 2019.

We also believe we can continue to deliver positive 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 and digital customer engagement. 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.

Results of Operations for Thirteen Weeks Ended March 31, 2019 and April 1, 2018

The following tables set forth our unaudited results of operations and other operating data for the periods presented. As of December 31, 2018, we adopted the Accounting Standards Update (ASU) 2016-02: Leases (Topic 842) (the New Lease Standard). This adoption did not require us to recast prior periods; however, we recognized a cumulative effect adjustment, which increased retained earnings by \$21 million, net of tax. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods. All dollar amounts are in thousands, unless otherwise noted.

	Thirteen weeks ended March 31, April 1,	
	2019	2018 (1)
Unaudited Quarterly Consolidated Statement of Income Data:		
Net sales	\$1,413,887	\$1,287,196
Cost of sales	929,538	842,587
Gross profit	484,349	444,609
Selling, general and administrative expenses	374,826	338,774
Depreciation and amortization (exclusive of depreciation included in cost of sales)	29,459	26,145
Store closure and other costs	508	10
Income from operations	79,556	79,680
Interest expense, net	(5,002)	(6,064)
Other income	—	207
Income before income taxes	74,554	73,823
Income tax provision	(18,162)	(7,199)
Net income	\$56,392	\$66,624
Weighted average shares outstanding	123,258	132,423
Diluted effect of equity-based awards	668	1,329
Weighted average shares and equivalent shares outstanding	123,926	133,752
Diluted net income per share	\$0.46	\$0.50

	Thirteen weeks ended March April 31, 1,	
	2019	2018
Other Operating Data:		
Comparable store sales growth	1.4 %	2.7 %
Stores at beginning of period	313	285
Closed	—	—
Opened	8	9
Stores at end of period	321	294

- (1) Effective in the fourth quarter of fiscal year 2018, we made a voluntary change in accounting principle to change the classification of certain expenses on our consolidated statements of income. The change was applied retrospectively to all periods presented. See Note 2, “Summary of Significant Accounting Policies” for further information.

Comparison of Thirteen Weeks Ended March 31, 2019 to Thirteen Weeks Ended

April 1, 2018

Net sales

	Thirteen weeks ended				
	March 31, 2019	April 1, 2018	Change	% Change	
Net sales	\$1,413,887	\$1,287,196	\$126,691	10	%
Comparable store sales growth	1.4	% 2.7	%		

Net sales during the thirteen weeks ended March 31, 2019 totaled \$1.4 billion, an increase of 10% over the same period of the prior fiscal year. Sales growth was primarily driven by strong performance in new stores opened in the last twelve months and a 1.4% increase in comparable store sales. Comparable stores contributed approximately 91% of total sales for the thirteen weeks ended March 31, 2019 and approximately 89% for the same period of the prior fiscal year.

Cost of sales and gross profit

	Thirteen weeks ended				
	March 31, 2019	April 1, 2018	Change	% Change	
Net sales	\$1,413,887	\$1,287,196	\$126,691	10	%
Cost of sales	929,538	842,587	86,951	10	%
Gross profit	484,349	444,609	39,740	9	%
Gross margin	34.3	% 34.5	% (0.2	)%	

Gross profit totaled \$484.3 million during the thirteen weeks ended March 31, 2019, an increase of \$39.7 million compared to the thirteen weeks ended April 1, 2018, primarily driven by increased sales volume and strong performance in new stores opened. Gross margin decreased to 34.3%, or 0.2% compared to the thirteen weeks ended April 1, 2018, primarily driven by cost inflation that was not fully reflected in retail pricing due to the competitive landscape, as well as changes in product mix.

Selling, general and administrative expenses

	Thirteen weeks ended					
	March	April 1,				
	31, 2019	2018	Change	% Change		
Selling, general and administrative						
expenses	\$374,826	\$338,774	\$36,052	11	%	
Percentage of net sales	26.5	% 26.3	% 0.2	%		

Selling, general and administrative expenses increased \$36.1 million, or 11%, as compared to the thirteen weeks ended April 1, 2018. The increase is primarily related to the new stores which have opened since the same period of the prior fiscal year. As a percentage of net sales, selling, general and administrative expenses increased primarily due to higher occupancy costs related to the adoption of the new lease accounting standard that went into effect at the beginning of fiscal year 2019, along with planned investments in team member wages, benefits and training. These increased costs were partially offset by lower payroll taxes for California team members, rent credits from delayed store openings, as well as reduced stock and bonus compensation expenses predominately related to the open chief executive officer position.

Depreciation and amortization

	Thirteen weeks ended March 31, 2019					
	ended March 31, 2019		April 1, 2018		Change	% Change
Depreciation and amortization	\$29,459		\$26,145		\$3,314	13 %
Percentage of net sales	2.1	%	2.0	%	0.1	%

Depreciation and amortization expenses (exclusive of depreciation included in cost of sales) increased \$3.3 million primarily related to new store growth as well as remodel initiatives in older vintages.

Store closure and other costs

	Thirteen weeks ended March 31, 2019			
	ended March 31, 2019		April 1, 2018	
Store closure and other costs	\$508		\$ 10	
Percentage of net sales	—		—	

Store closure and other costs during the thirteen weeks ended March 31, 2019 of \$0.5 million represents non-cash charges primarily associated with a planned store closure and relocation of another store upon expiration of both leases in the second quarter of 2019.

Interest expense

	Thirteen weeks ended March 31, 2019			
	ended March 31, 2019		April 1, 2018	
Long-term debt	\$4,715		\$2,712	
Capital and financing leases	255		3,040	
Deferred financing costs	141		376	
Interest rate hedge and other	(109)		(64)	
Total interest expense, net	\$5,002		\$6,064	

The decrease in interest expense is due to the reclassification of previously reported financing leases to operating leases related to the adoption of the new lease accounting standard that went into effect at the beginning of 2019, partially offset by the higher average balance outstanding under the Amended and Restated Credit Agreement primarily related to the Company's share repurchase program.

Income tax provision

Income tax provision differed from the amounts computed by applying the U.S. federal income tax rate to pretax income as a result of the following:

	Thirteen weeks ended March 31, 2019		April 1, 2018	
Federal statutory rate	21.00%		21.00	%
Change in income taxes resulting from:				
State income taxes, net of federal benefit	4.90		4.50	
Excess tax benefits from share based payments	(0.30)		(15.10)	
Other, net	(1.20)		(0.60)	
Effective tax rate	24.40%		9.80	%

The effective tax rate increased to 24.4% in the first quarter of 2019 from 9.8% in the same period last year. This increase is due primarily to the inclusion of the \$11 million of excess federal and state tax benefits for share based compensation associated with the exercise of expiring pre-IPO options in the thirteen weeks ended April 1, 2018.

Net income

	Thirteen weeks ended March 31,				April 1,		
	2019		2018		2018	Change	% Change
Net income	\$56,392		\$66,624			\$(10,232)	(15)%
Percentage of net sales	4.0	%	5.2	%		(1.2)	)%

Net income decreased \$10.2 million as a result of cycling a lower effective tax rate in 2018, due to the exercise of expiring pre-IPO options and the adoption of the new lease accounting standard, partially offset by higher sales and gross profit associated with new stores opened.

Diluted earnings per share

	Thirteen weeks ended			
	March 31, 2019	April 1, 2018	Change	% Change
Diluted earnings per share	\$0.46	\$0.50	\$(0.04)	(8)%
Diluted weighted average shares				
outstanding	123,926	133,752	(9,826)	

The decrease in diluted earnings per share of \$0.04 was driven by lower net income, offset by fewer diluted shares outstanding compared to the prior year, due primarily to the share repurchase program.

Return on Invested Capital

In addition to reporting financial results in accordance with generally accepted accounting principles, or GAAP, we provide information regarding Return on Invested Capital (referred to as "ROIC") as additional information about our operating results. ROIC is a non-GAAP financial measure and should not be reviewed in isolation or considered as a

substitute for our financial results as reported in accordance with GAAP. ROIC is an important measure used by management to evaluate our investment returns on capital and provides a meaningful measure of the effectiveness of our capital allocation over time.

We define ROIC as net operating profit after tax (referred to as “NOPAT”), including the effect of capitalized operating leases, divided by average invested capital. Operating lease interest represents the add-back to operating income driven by the hypothetical interest expense we would incur if the property under our operating leases were owned or accounted for as a finance lease (capital lease prior to adoption of ASC 842). The assumed ownership and associated interest expense are calculated using the discount rate for each lease as recorded as a component of rent expense within selling, general and administrative expenses. Invested capital reflects a trailing twelve-month average.

As numerous methods exist for calculating ROIC, our method may differ from methods used by other companies to calculate their ROIC. It is important to understand the methods and the differences in those methods used by other companies to calculate their ROIC before comparing our ROIC to that of other companies.

Our calculation of ROIC for the fiscal periods indicated was as follows:

	Rolling Four Quarters Ended			
	March 31, 2019		April 1, 2018	
	(dollars in thousands)			
Net Income (1)	\$ 148,303		\$ 178,776	
Income Tax Adjustment for Tax Act (2)	(2,573)		(18,693)	
Special items, net of tax (3)	11,950		—	
Interest expense, net of tax (4)	19,993		17,035	
Net operating profit after tax (NOPAT)	\$ 177,673		\$ 177,118	
Total rent expense, net of tax (4)	109,803		95,151	
Estimated depreciation on operating leases, net of tax (4)	(42,421)		(41,866)	
Estimated interest on operating leases, net of tax (4) (5) (6)	67,382		53,285	
NOPAT, including effect of operating leases	\$ 245,055		\$ 230,403	
Average working capital	32,029		4,416	
Average property and equipment	751,434		695,375	
Average other assets	574,183		571,313	
Average other liabilities	(184,481)		(169,221)	
Average invested capital	\$ 1,173,165		\$ 1,101,883	
Average operating leases (7)	1,142,013		1,005,567	
Average invested capital, including operating leases	\$ 2,315,178		\$ 2,107,450	
ROIC	15.1	%	16.1	%
ROIC, including operating leases	10.6	%	10.9	%

(1) Net income amounts represent total net income for past four trailing quarters.

(2) \$18.7 million income tax benefit related to the Tax Cuts and Job Act enacted in December 2017 and \$2.6 million income tax benefit related to tax calculation method changes recognized in the third quarter of 2018.

(3) Special items include \$6.3 million (after-tax) related to store closures and \$5.7 million (after-tax) related to executive severance.

(4) Net of tax amounts are calculated using the effective tax rate for the periods presented.

(5) 2019 interest on operating leases represents the add back to operating income driven by hypothetical interest expense we would incur if the property under our operating leases were accounted for as financing leases. Estimated interest is calculated by multiplying operating leases by the 7.8 percent discount rate for each lease recorded as rent expense.

(6) 2018 interest on operating leases is calculated as the trailing four quarters' rent expense multiplied by eight and by a 7.0 percent interest rate factor.

(7) 2019 average operating leases represents the net present value of outstanding operating lease obligations. 2018 average operating leases is calculated as the trailing four quarters' rent expense multiplied by eight and by a 7.0

percent interest rate factor.

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, cash equivalents and restricted cash at the end of each period (in thousands):

	Thirteen weeks ended	
	March 31, 2019	April 1, 2018
Cash, cash equivalents and restricted cash at end of period	\$20,982	\$21,356
Cash flows from operating activities	\$112,605	\$104,487
Cash flows used in investing activities	\$(30,142)	\$(44,158)
Cash flows used in financing activities	\$(63,729)	\$(58,452)

We have generally financed our operations principally through cash generated from operations and borrowings under our credit facilities. Our primary uses of cash are for purchases of inventory, operating expenses, capital expenditures primarily for opening new stores, remodels and maintenance, repurchases of our common stock and debt service. We believe that our existing cash, cash equivalents and restricted cash, and cash anticipated to be generated from operations will be sufficient to meet our anticipated cash needs for at least the next 12 months, and we may continue to use borrowings under our Amended and Restated Credit Agreement as discussed in Note 4, "Long-Term Debt and Finance Lease Liabilities," primarily to fund our share repurchase programs. 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, cash equivalents and restricted cash position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within days from the related sale.

Operating Activities

Cash flows from operating activities increased \$8.1 million to \$112.6 million for the thirteen weeks ended March 31, 2019 compared to \$104.5 million for the thirteen weeks ended April 1, 2018. The increase in cash flows from operating activities is primarily a result of changes in working capital, higher non-cash depreciation and amortization, partially offset by lower share-based compensation and deferred income taxes.

Cash flows provided by/(used in) operating activities from changes in working capital was \$18.2 million in the thirteen weeks ended March 31, 2019 compared to (\$7.5) million in the thirteen weeks ended April 1, 2018.

Investing Activities

Cash flows used in investing activities consist primarily of capital expenditures in new stores, including leasehold improvements and store equipment, capital expenditures to maintain the appearance of our stores, sales enhancing initiatives and other corporate investments. Cash flows used in investing activities were \$30.1 million and \$44.2 million, for the thirteen weeks ended March 31, 2019 and April 1, 2018, respectively.

We expect capital expenditures to be in the range of \$170 - \$175 million in fiscal year 2019, including expenditures incurred to date, net of estimated landlord tenant improvement allowances, primarily to fund investments in new stores, remodels, maintenance capital expenditures and corporate capital expenditures. We expect to fund our capital

expenditures with cash on hand, cash generated from operating activities and, if required, borrowings under our Amended and Restated Credit Agreement.

Financing Activities

Cash flows used in financing activities were \$63.7 million for the thirteen weeks ended March 31, 2019 compared to \$58.5 million for the thirteen weeks ended April 1, 2018. During the thirteen weeks ended March 31, 2019, cash flows used in financing activities primarily consisted of \$111.9 million for stock repurchases, partially offset by \$47.0 million of net borrowings on our credit facilities, and \$1.7 million in proceeds from the exercise of stock options.

During the thirteen weeks ended April 1, 2018, cash flows used in financing activities primarily consisted of \$83.0 million for stock repurchases, partially offset by \$20.0 million of net borrowings on our credit facilities, and \$6.9 million in proceeds from the exercise of stock options.

Long-Term Debt and Credit Facilities

Long-term debt increased \$47.0 million to \$500.0 million as of March 31, 2019, compared to December 30, 2018. The increase resulted primarily from net borrowings under our Amended and Restated Credit Agreement used to fund our share repurchase programs.

See Note 4, “Long-Term Debt and Finance Lease Liabilities” of our unaudited consolidated financial statements for a description of our Amended and Restated Credit Agreement and our Former Credit Facility (each as defined therein).

Share Repurchase Program

Our board of directors from time to time authorizes share repurchase programs for our common stock. The following table outlines the share repurchase programs authorized by our board, and the related repurchase activity and available authorization as of March 31, 2019.

		Amount	Cost of	Authorization
Effective date	Expiration date	authorized	repurchases	available
November 4, 2015	November 4, 2017	\$ 150,000	\$ 150,000	\$ —
September 6, 2016	December 31, 2017	\$ 250,000	\$ 250,000	\$ —
February 20, 2017	December 31, 2018	\$ 250,000	\$ 250,000	\$ —
February 20, 2018	December 31, 2019	\$ 350,000	\$ 243,592	\$ 106,408

The shares under our repurchase programs may be purchased on a discretionary basis from time to time prior to the applicable expiration date, 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. Our board’s authorization of the share repurchase programs does not obligate our Company to acquire any particular amount of common stock, and the repurchase programs may be commenced, suspended, or discontinued at any time. We have used borrowings under our Former Credit Facility and Amended and Restated Credit Agreement to assist with the repurchase programs. See Note 4, “Long-Term Debt and Finance Lease Liabilities” of our unaudited consolidated financial statements, for more details.

Share repurchase activity under our repurchase programs for the periods indicated was as follows (total cost in thousands):

	Thirteen Weeks Ended	
	March 31,	April 1,
	2019	2018
Number of common shares acquired	4,890,766	3,329,409
Average price per common share acquired	\$ 22.88	\$ 24.93
Total cost of common shares acquired	\$ 111,885	\$ 83,000

Shares purchased under our repurchase programs were subsequently retired.

Subsequent to March 31, 2019 and through April 29, 2019, we repurchased an additional 2.4 million shares of common stock for a total investment of \$51.4 million year-to-date.

Contractual Obligations

We are committed under certain capital leases for the rental of certain land and buildings and certain operating leases for rental of facilities and equipment. These leases expire or become subject to renewal clauses at various dates through 2036.

The following table summarizes our contractual obligations as of March 31, 2019, 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	3-5 Years	More Than 5 Years
	(in thousands)				
\$700.0 million Credit Agreement (1)	500,000	\$—	\$—	\$500,000	\$—
Interest payments on \$700.0 million Credit Agreement (2)	84,458	19,438	39,917	25,103	—
Finance lease obligations (3)	19,921	1,577	3,183	3,391	11,770
Operating lease obligations (3)	1,757,952	183,454	380,006	335,385	859,107
Totals	\$2,362,331	\$204,469	\$423,106	\$863,879	\$870,877

- (1) The Amended and Restated Credit Agreement is scheduled to mature and the commitments thereunder will terminate on March 27, 2023, subject to extensions as set forth therein. These borrowings are reflected in the “3-5 Years” column and discussed in the financing activities section above. See Note 4, “Long-Term Debt and Finance Lease Liabilities” to our unaudited consolidated financial statements located elsewhere in this Quarterly Report on Form 10-Q.
- (2) Represents estimated interest payments through the March 27, 2023 maturity date of our Amended and Restated Credit Agreement based on the outstanding amounts as of March 31, 2019 and based on LIBOR rates in effect at the time of this report, net of interest rate swaps.
- (3) Represents estimated payments for finance and operating lease obligations as of March 31, 2019. Lease obligations are presented gross without offset for subtenant rentals. We have subtenant agreements under which we will receive \$1.6 million for the period of less than one year, \$2.9 million for years one to three, \$2.4 million for years four to five, and \$2.9 million for the period beyond five years.

We have other contractual commitments which were presented under Contractual Obligations in our Annual Report on Form 10-K for the fiscal year ended December 30, 2018, and for which there have not been material changes since that filing through March 31, 2019.

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 Deflation and Inflation

Deflation and inflation in the prices of food and other products we sell may periodically affect our sales, gross profit and gross margin. Food deflation across multiple categories, particularly in produce, could reduce sales growth and earnings if our competitors react by lowering their retail pricing and expanding their promotional activities, which can lead to retail deflation higher than cost deflation that could reduce our sales, gross profit margins and comparable store sales. Food inflation, when combined with reduced consumer spending, could also reduce sales, gross profit margins and comparable store sales. The short-term impact of deflation and inflation is largely dependent on whether or not the effects are passed through to our customers, which is subject to competitive market conditions.

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

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 share-based awards and derivatives, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

There have been no substantial changes to these estimates, or the policies related to them during the thirteen weeks ended March 31, 2019, except as described in Note 5, “Leases” for the adoption of ASC 842. For a full discussion of these estimates and policies, see “Critical Accounting Estimates” in Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 30, 2018.

Recently Issued Accounting Pronouncements

See Note 2, “Summary of Significant Accounting Policies” to our accompanying unaudited consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As described in Note 4, “Long-Term Debt” to our unaudited consolidated financial statements located elsewhere in this Quarterly Report on Form 10-Q, we have an Amended and Restated Credit Agreement that bears interest at a rate based in part on LIBOR. Accordingly, we are exposed to fluctuations in interest rates. Based on the \$500 million principal outstanding under our Amended and Restated Credit Agreement as of March 31, 2019, each hundred basis point change in LIBOR would result in a change in interest expense by \$5.0 million annually. We have entered into an interest rate swap agreement in December 2017 to manage our cash flow associated with variable interest rates. The notional dollar amount of the five outstanding swaps at March 31, 2019 and December 30, 2018 was \$250.0 million under which we pay a fixed rate and received a variable rate of interest (cash flow swap). Taking into account the interest rate swaps, based on the \$500 million principal outstanding under our Amended and Restated Credit Agreement as of March 31, 2019, each hundred basis point change in LIBOR would result in a change in interest expense by \$2.5 million annually.

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

We do not enter into derivative financial instruments for trading purposes (see Note 12, “Derivative Financial Instruments” of our unaudited consolidated financial statements).

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) designed to ensure that the information required to be disclosed by us in the reports that we file or

submit under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to our management, including our Interim Co-Chief Executive Officers and Chief Financial Officer (our co-principal executive officers and our principal financial officer), as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Interim Co-Chief Executive Officers (one of whom is also our Chief Financial Officer), has evaluated the effectiveness of our disclosure controls and procedures under the Exchange Act as of March 31, 2019, the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Interim Co-Chief Executive Officers have concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the quarterly period ended March 31, 2019, there were no change in our internal controls over financial reporting that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

During the quarterly period ended March 31, 2019, we were in the process of implementing a new company-wide enterprise resource planning (ERP) system that went live on April 29, 2019. This implementation did not have an impact on our internal controls over financial reporting during the quarterly period ended March 31, 2019.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

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

Securities Action

On March 4, 2016, a complaint was filed in the Superior Court for the State of Arizona against our company and certain of our directors and officers on behalf of a purported class of purchasers of shares of our common stock in our underwritten secondary public offering which closed on March 10, 2015 (the “March 2015 Offering”). The complaint purports to state claims under Sections 11, 12 and 15 of the Securities Act of 1933, as amended, based on an alleged failure by our company to disclose adequate information about produce price deflation in the March 2015 Offering documents. The complaint seeks damages on behalf of the purported class in an unspecified amount, rescission, and an award of reasonable costs and attorneys’ fees. After removal to federal court, the plaintiff sought remand, which the court granted in March 2017. On May 25, 2017, our company filed a Motion to Dismiss in the Superior Court for the State of Arizona, which the court granted in part and denied in part by order entered August 30, 2017. On August 4, 2018, we reached an agreement in principle to settle these claims. The parties’ settlement agreement was granted preliminary approval by the court on January 30, 2019, with a hearing for final approval scheduled for May 31, 2019. If approved by the court, the settlement will be funded from our directors and officer’s liability insurance policy and will not have a material impact on our consolidated financial statements.

“Phishing” Scam Actions

In April 2016, four complaints were filed, two in the federal courts of California, one in the Superior Court of California and one in the federal court in the District of Colorado, each on behalf of a purported class of our current and former team members whose personally identifiable information (“PII”) was inadvertently disclosed to an unauthorized third party that perpetrated an email “phishing” scam against one of our team members. The complaints allege we failed to properly safeguard the PII in accordance with applicable law. The complaints seek damages on behalf of the purported class in unspecified amounts, attorneys’ fees and litigation expenses. In June 2016, a motion was filed before the Judicial Panel on Multidistrict Litigation (“JPML”) to transfer and consolidate all four of the cases to the federal court in the District of Arizona. The JPML granted the motion on October 6, 2016. On May 24, 2017, the JPML granted our motion to stay proceedings in the case pending a U.S. Supreme Court ruling on the question of whether arbitration agreements like those signed by each of the named plaintiffs are enforceable. On May 21, 2018, the Supreme Court issued its opinion in *Epic Systems Corp. v. Lewis* and upheld enforceability of arbitration agreements containing class action waivers, like the ones the named plaintiffs signed in this matter. On March 1, 2019, a number of individual plaintiffs filed arbitration demands, and we expect to file our response to these arbitration demands in the second quarter of 2019. We intend to defend these cases vigorously, but it is not possible at this time to reasonably estimate the outcome of, or any potential liability from, the cases.

Proposition 65 Coffee Action

On April 13, 2010, an organization named Council for Education and Research on Toxics (“CERT”) filed a lawsuit in the Superior Court of the State of California, County of Los Angeles, against nearly 80 defendants who manufacture, package, distribute or sell brewed coffee, including Sprouts. CERT alleges that the defendants failed to provide warnings for their coffee products of exposure to the chemical acrylamide as required under California Health and Safety Code section 25249.5, the California Safe Drinking Water and Toxic Enforcement Act of 1986, better known as Proposition 65. CERT seeks equitable relief, including providing warnings to consumers of coffee products, as well as civil penalties.

Our company, as part of a joint defense group, asserted multiple defenses against the lawsuit. On May 7, 2018, the trial court issued a ruling adverse to defendants on these defenses to liability. On June 15, 2018, before the court tried damages, remedies and attorneys' fees, California's Office of Environmental Health Hazard Assessment ("OEHHA") published a proposal to amend Proposition 65's implementing regulations by adding a stand-alone sentence that reads as follows: "Exposures to listed chemicals in coffee created by and inherent in the processes of roasting coffee beans or brewing coffee do not pose a significant risk of cancer." OEHHA submitted the proposed regulation to California's Office of Administrative Law, and expects that the proposed regulation, if finalized, could be effective as early as July 2019. The joint defense group sought a stay of the lawsuit pending resolution of OEHHA's rulemaking, and a temporary stay order was granted by the Court of Appeal of the State of California on October 12, 2018 and continued on January 31, 2019, until further order. We expect the court to extend the stay until after OEHHA's rulemaking is completed.

At this stage of the proceedings, prior to a trial on the remedies issues, Sprouts is unable to predict or reasonably estimate the potential loss or effect on our company or our operations. Accordingly, no loss contingency was recorded for this matter. If the proposed regulation is not adopted, or the court determines that it does not apply to this case, the trial court has discretion to impose zero penalties against our company or to impose significant statutory penalties. Significant labeling or warning requirements that could potentially be imposed by the trial court may increase our costs and adversely affect sales of our coffee products. Furthermore, a future appellate court decision could reverse the trial court rulings. The outcome and the financial impact of settlement or the trial or appellate court rulings of the case to our company, if any, cannot be predicted.

Item 1A. Risk Factors.

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

There have been no material changes to the Risk Factors described under "Part I – Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 30, 2018.

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

Issuer Purchases of Equity Securities

The following table provides information about our share repurchase activity during the thirteen weeks ended March 31, 2019.

Period (1)	Total number	Average	Total number of	Approximate dollar
	of shares	price paid	shares purchased	value of shares
	purchased	per share	as part of publicly	that may yet be

				announced plans	purchased under
				or programs	the plans or
					programs
December 31, 2018 - January 27, 2019	837,532	\$ 23.88	837,532		\$ 126,752,000
January 28, 2019 - February 24, 2019	14,946	\$ 22.99	14,946		\$ 106,752,000
February 25, 2019 - March 31, 2019	4,038,288	\$ 22.67	4,038,288		\$ 106,408,000

(1) Periodic information is presented by reference to our fiscal periods during the first quarter of fiscal year 2019.

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Item 6. Exhibits.

Exhibit

Number Description

- | | |
|---------|--|
| 10.1 | <u>2019 Form of Performance Share Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan</u> |
| 10.2 | <u>Amendment No. 1 to Amended and Restated Credit Agreement, dated as of March 6, 2019, among Sprouts Farmers Markets Holdings, LLC, the Lenders party thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent (1)</u> |
| 31.1 | <u>Certification of Interim Co-Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 31.2 | <u>Certification of Interim Co-Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1 | <u>Certification of Interim Co-Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 32.2 | <u>Certification of Interim Co-Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| (1) | Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on March 7, 2019, and incorporated herein by reference. |

SIGNATURES

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

SPROUTS FARMERS MARKET, INC.

Date: May 2, 2019 By: /s/ Bradley S. Lukow

Name: Bradley S. Lukow

Title: Interim Co-Chief Executive Officer and Chief Financial Officer

(Co-Principal Executive Officer and Principal Financial and Accounting Officer)