Section 1: 10-Q (10-Q)

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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 incorporation or organization)	(I.R.S. Employer Identification No.)

5455 East High Street, Suite 111
Phoenix, Arizona 85054
(Address of principal executive offices and zip code)

(480) 814-8016
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 ☐

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 ☒

As of October 29, 2018, the registrant had 127,603,836 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 SEPTEMBER 30, 2018

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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," "continue," "objective," or the negative of these terms, and similar expressions intended to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and involve known risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievement to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" included in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, 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)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,175	$ 19,479
Accounts receivable, net	34,631	25,893
Inventories	253,045	229,542
Prepaid expenses and other current assets	37,523	24,593
Total current assets	342,374	299,507
Property and equipment, net of accumulated depreciation	773,348	713,031
Intangible assets, net of accumulated amortization	195,154	196,205
Goodwill	368,078	368,078
Other assets	16,010	4,782
Total assets	$ 1,694,964	$ 1,581,603
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 245,928	$ 244,853
Accrued salaries and benefits	43,433	45,623
Current portion of capital and financing lease obligations	7,398	9,238
Total current liabilities	296,759	299,714
Long-term capital and financing lease obligations	120,670	125,489
Long-term debt	435,000	348,000
Other long-term liabilities	144,401	130,640
Deferred income tax liability	56,839	27,066
Total liabilities	1,053,669	930,909
Commitments and contingencies (Note 8)		
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, 127,603,836 shares issued and outstanding, September 30, 2018; 132,823,981 shares issued and outstanding, December 31, 2017	127	132
Additional paid-in capital	653,509	620,788
Accumulated other comprehensive income (loss)	4,567	(784)
(Accumulated deficit) retained earnings	(16,908)	30,558
Total stockholders' equity	641,295	650,694
Total liabilities and stockholders' equity	$ 1,694,964	$ 1,581,603

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		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Net sales	$ 1,329,109	$ 1,206,059	$ 3,937,998	$ 3,520,679
Cost of sales, buying and occupancy	946,734	859,650	2,788,159	2,494,998
Gross profit	382,375	346,409	1,149,839	1,025,681
Direct store expenses	281,365	250,191	816,933	715,336
Selling, general and administrative expenses	43,944	39,955	128,828	110,312
Store pre-opening costs	3,819	2,456	9,414	10,055
Store closure and other costs	461	803	497	992
Income from operations	52,786	53,004	194,167	188,986
Interest expense	(7,419)	(5,609)	(20,028)	(15,447)
Other income	—	162	325	388
Income before income taxes	45,367	47,557	174,464	173,927
Income tax provision	(7,867)	(16,071)	(28,631)	(55,186)
Net income	$ 37,500	$ 31,486	$ 145,833	$ 118,741
Net income per share:				
Basic	$ 0.30	$ 0.23	$ 1.13	$ 0.87
Diluted	$ 0.29	$ 0.23	$ 1.12	$ 0.86
Weighted average shares outstanding:				
Basic	126,855	134,320	129,572	136,063
Diluted	127,627	136,770	130,537	138,860

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		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Net income	$ 37,500	$ 31,486	$ 145,833	$ 118,741
Other comprehensive income, net of tax				
Unrealized gain on cash flow hedging activities, net of income tax of $299, $0, $1,851 and $0	865	—	5,351	—
Total other comprehensive income	$ 865	$ —	$ 5,351	$ —
Comprehensive income	$ 38,365	$ 31,486	$ 151,184	$ 118,741

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)

	Shares	Common Stock	Additional Paid In Capital	(Accumulated deficit) Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances at January 1, 2017	140,002,242	$ 140	$597,269	$ 75,500	$ —	$ 672,909
Net income	—	—	—	158,440	—	158,440
Other comprehensive income (loss)	—	—	—	—	(784)	(784)
Issuance of shares under stock plans	2,144,669	2	9,298	—	—	9,300
Repurchase and retirement of common stock	(9,696,819)	(10)	—	(203,382)	—	(203,392)
Equity-based compensation	—	—	14,221	—	—	14,221
Balances at December 31, 2017	132,450,092	$ 132	$620,788	$ 30,558	$ (784)	$ 650,694
Net income	—	—	—	145,833	—	145,833
Other comprehensive income (loss)	—	—	—	—	5,351	5,351
Issuance of shares under stock plans	3,170,818	3	21,048	—	—	21,051
Repurchase and retirement of common stock	(8,411,575)	(8)	—	(193,299)	—	(193,307)
Equity-based compensation	—	—	11,673	—	—	11,673
Balances at September 30, 2018	127,209,335	$ 127	$653,509	$ (16,908)	$ 4,567	641,295

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)

	Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017
Cash flows from operating activities		
Net income	$ 145,833	$ 118,741
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	81,959	70,875
Accretion of asset retirement obligation and closed store reserve	219	168
Amortization of financing fees and debt issuance costs	658	347
Loss on disposal of property and equipment	404	820
Equity-based compensation	11,673	10,325
Deferred income taxes	29,773	23,245
Changes in operating assets and liabilities:		
Accounts receivable	(10,299)	1,660
Inventories	(23,503)	(17,752)
Prepaid expenses and other current assets	(13,758)	(3,734)
Other assets	(3,945)	(702)
Accounts payable and other accrued liabilities	3,240	35,957
Accrued salaries and benefits	(2,130)	8,360
Other long-term liabilities	15,342	10,659
Cash flows from operating activities	235,466	258,969
Cash flows from investing activities		
Purchases of property and equipment	(148,433)	(158,459)
Proceeds from sale of property and equipment	1	30
Cash flows used in investing activities	(148,432)	(158,429)
Cash flows from financing activities		
Proceeds from revolving credit facilities	180,000	134,000
Payments on revolving credit facilities	(93,000)	(40,000)
Payments on capital and financing lease obligations	(3,349)	(3,053)
Payments of deferred financing costs	(2,131)	-
Cash from landlords related to capital and financing lease obligations	2,113	300
Repurchase of common stock	(193,307)	(192,000)
Proceeds from exercise of stock options	21,051	6,640
Other	(59)	—
Cash flows used in financing activities	(88,682)	(94,113)
(Decrease) increase in cash, cash equivalents, and restricted cash	(1,648)	6,427
Cash, cash equivalents, and restricted cash at beginning of the period	19,479	12,465
Cash, cash equivalents, and restricted cash at the end of the period	$ 17,831	$ 18,892
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 19,784	$ 15,052
Cash paid for income taxes	15,177	25,710
Supplemental disclosure of non-cash investing and financing activities		
Property and equipment in accounts payable	$ 15,435	$ 13,476
Property acquired through capital and financing lease obligations	8,911	5,512

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

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

1. Basis of Presentation

Sprouts Farmers Market, Inc., a Delaware corporation, through its subsidiaries, operates as a healthy grocery store that offers fresh, natural and organic food through a complete shopping experience that includes fresh produce, bulk foods, vitamins and supplements, 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 31, 2017 ("fiscal year 2017") included in the Company's Annual Report on Form 10-K, filed on February 22, 2018.

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 30, 2018 ("fiscal year 2018") and fiscal year 2017 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.

2. Summary of Significant Accounting Policies

Revenue Recognition

The Company has adopted Accounting Standards Codification ("ASC") 606, "Revenue from Contracts with Customers" in the first quarter of fiscal year 2018, with a date of initial application of January 1, 2018, using the modified retrospective approach. Comparative information presented has not been adjusted and continues to be reported under ASC 605.

The Company applied ASC 606 to all of its contracts with customers. As a result of the adoption, there is no impact to any financial statement line item, and the Company has recorded no impact to opening retained earnings as of January 1, 2018.

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, any contract performance obligations, or any material costs to obtain or fulfill a contract as of September 30, 2018. The Company had a net gift card liability balance of $6.8 million as of September 30, 2018 and $13.1 million as of December 31, 2017. During the thirty-nine weeks ended September 30, 2018, the Company recognized $16.1 million in sales related to gift cards redeemed by customers.

Revenue is recognized at the point of sale. The Company's performance obligations are satisfied upon the transfer of goods to the customer, at the point of sale, and payment from customers is also due at the time of sale. Proceeds from the sale of gift cards are recorded as a liability at the time of sale, and recognized as sales when they are redeemed by the customer and the performance obligation is satisfied by the Company.

The nature of goods the Company transfers to customers at the point of sale are inventories, consisting of merchandise purchased for resale.

Restricted Cash

Restricted cash relates to defined benefit plan forfeitures of approximately $0.7 million and is included in prepaid expenses and other current assets in the consolidated balance sheets.

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers." ASU No. 2014-09 provides guidance for revenue recognition. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, and estimating the amount of variable consideration to include in the transaction price attributable to each separate performance obligation. Subsequent to the initial standards, the FASB has also issued several ASUs to clarify specific revenue recognition topics. The Company adopted ASC 606 effective January 1, 2018 using the modified retrospective approach. As noted above, there is no impact to any financial statement line item as a result of the adoption, and the Company has recorded no impact to opening retained earnings as of January 1, 2018. The Company has added additional disclosures of disaggregated revenue by type in Note 13, "Segments."

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities-Extinguishments of Liabilities (Subtopic 405-20): Recognition of breakage for certain prepaid stored-value products." ASU No. 2016-04 provides a narrow scope exception to the guidance in Subtopic 405-20 to require that stored-value breakage be accounted for consistently with the breakage guidance in Topic 606. The amendments in this update contain specific guidance for derecognition of prepaid stored-value product liabilities, thereby eliminating the current and potential future diversity. The guidance was effective for the Company for its fiscal year 2018. The Company adopted this guidance using the modified retrospective approach. As noted above, there is no impact to any financial statement line item as a result of the adoption, and the Company recorded no impact to opening retained earnings as of January 1, 2018.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” This update provides clarifications on the cash flow classification for eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. Adoption of this guidance took place during the first quarter of fiscal year 2018, using the retrospective transition method, and the adoption had no impact on the Company’s consolidated financial statements or disclosures.

In November 2016, the FASB issued ASU No. 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Adoption of this guidance took place prospectively during the first quarter of 2018, and the adoption did not have a material impact on the Company’s consolidated financial statements or disclosures.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting.” The amendments in this update provide guidance about which changes to the terms or conditions of a share-based award require an entity to apply modification accounting in Topic 718. Adoption of this guidance took place prospectively during the first quarter 2018, and the adoption did not have an impact on the Company’s consolidated financial statements or disclosures.

In August 2018, the FASB issued ASU No. 2018-15, “Intangibles —Goodwill and Other —Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.” The amendments in this update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include internal-use software license). The amendments require an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which service contract implementation costs to capitalize as an asset and which costs to expense. The amendments also require the entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangements, which includes reasonably certain renewals. The Company adopted this guidance during the third quarter 2018 using the prospective transition approach. Adoption of the guidance did not have a material impact to the Company's financial statements and resulted in capitalization of implementation costs associated with various technology initiatives which are included in other assets in the consolidated balance sheet as of September 30, 2018.

Recently Issued Accounting Pronouncements Not Yet Adopted

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. Certain additional quantitative and qualitative disclosures will also be required. This ASU will be effective for the Company beginning with its 2019 fiscal year. While the Company is still evaluating the impact of this ASU, the Company expects it will result in material increases in assets and liabilities in its consolidated balance sheet and enhanced disclosures. In addition, the Company anticipates that the transition of its financing leases to operating leases under the new standard will result in an increase in rent expense, partially offset by reductions to depreciation and interest expense. The Company does not expect that the adoption of the ASU will have an impact on the Company’s cash flows.

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 thirty-nine weeks ended September 30, 2018 had, or are expected to have, a material impact on the Company’s consolidated financial statements.

3. Fair Value Measurements

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

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

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

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

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

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 September 30, 2018 and December 31, 2017:

September 30, 2018	Level 1	Level 2	Level 3	Total
Long-term debt	$ —	$ 435,000	$ —	$ 435,000
Total liabilities	$ —	$ 435,000	$ —	$ 435,000
Interest rate swap asset	$ —	$ 6,159	$ —	$ 6,159
Total assets	$ —	$ 6,159	$ —	$ 6,159

December 31, 2017	Level 1	Level 2	Level 3	Total
Long-term debt	$ —	$ 348,000	$ —	$ 348,000
Interest rate swap liability	—	1,064	—	1,064
Total liabilities	$ —	$ 349,064	$ —	$ 349,064

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.

Cash, cash equivalents, and 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 September 30, 2018 and December 31, 2017.

4. Long-Term Debt

A summary of long-term debt is as follows:

Facility	Maturity	Interest Rate	As of September 30, 2018	As of December 31, 2017
Senior secured debt				
$700.0 million Credit Agreement	March 27, 2023	Variable	$ 435,000	$ —
Former Credit Facility	April 17, 2020	Variable	—	348,000
Total debt			435,000	348,000
Long-term debt			$ 435,000	$ 348,000

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 September 30, 2018.

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 $27.0 million have been issued as of September 30, 2018, primarily to support the Company's insurance programs.

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 57% of outstanding debt under the Amended and Restated Credit Agreement is fixed, reflecting the effects of floating to fixed interest rate swaps (see Note 11, "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 fiscal year 2017, the Company borrowed $153.0 million under the Former Credit Facility to be used in connection with the Company's $250.0 million share repurchase program (see Note 9, "Stockholders' Equity") and made a total of $60.0 million of principal payments; resulting in total outstanding debt under the Former Credit Facility of $348.0 million at December 31, 2017. During the thirty-nine weeks ended September 30, 2018, the Company borrowed an additional $180.0 million primarily for share repurchases and made a total of $93.0 million of principal payments; resulting in total outstanding debt under the Amended and Restated Credit Agreement of $435.0 million as of September 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;

- 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, starting with the fiscal quarter ended September 30, 2018.

The Company was in compliance with all applicable covenants under the Amended and Restated Credit Agreement as of September 30, 2018.

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. Closed Store Reserves

The following is a summary of closed store reserve activity during the thirty-nine weeks ended September 30, 2018 and fiscal year 2017:

	Thirty-nine Weeks Ended September 30, 2018	Fiscal Year Ended December 31, 2017
Beginning balance	$ 811	$ 1,083
Additions	—	—
Usage	(320)	(492)
Adjustments	85	220
Ending balance	$ 576	$ 811

Usage relates to lease payments made during the periods for closed stores.

6. Income Taxes

On December 22, 2017, the legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act") was enacted into law, which changed various corporate income tax provisions within the existing Internal Revenue Code. The most significant changes that impacted the Company were the reduction in the corporate federal income tax rate from 35% to 21% and 100% bonus depreciation for qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023.

Under the guidance set forth in the SEC's Staff Accounting Bulletin No. 118 (“SAB 118”), the Company may record provisional amounts for the impact of the Tax Act. As of September 30, 2018, the Company has finalized its 2017 federal income tax return and as such completed the accounting for the income tax effects of the 2017 Tax Act. In accordance with SAB 118, any future adjustments required due to changes in interpretation and guidance that may be issued will be recorded as discrete adjustments to income tax expense in the period in which those adjustments become estimable and finalized.

The Company’s effective tax rate decreased to 17.3% for the thirteen weeks ended September 30, 2018 from 33.8% for the thirteen weeks ended October 1, 2017 primarily due to the enactment of the Tax Act as disclosed above, as well as the impact of a tax calculation method change. During the quarter ended September 30, 2018 the Company adopted tax calculation method changes that resulted in the accelerated deduction or deferral of certain items. The method changes were included in the Company’s 2017 tax return that was finalized during the fiscal quarter. As a result, the Company recorded a $2.6 million discrete tax benefit in the third quarter of 2018, which decreased the effective tax rate by 5.7%.

The Company’s effective tax rate decreased to 16.4% for the thirty-nine weeks ended September 30, 2018 from 31.7% for the thirty-nine weeks ended October 1, 2017 primarily due to the enactment of the Tax Act disclosed above, as well as the recognition of excess tax benefits related to the exercise of stock options recognized in the income tax provision. The tax calculation method change resulted in a discrete rate benefit of 1.5% for the thirty-nine weeks ended September 30, 2018.

Excess tax benefits associated with share-based payment awards 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 share-based payment awards were $1.0 million and $0.2 million for the thirteen weeks ended September 30, 2018 and October 1, 2017, respectively. The income tax benefits resulting from excess tax benefits of share-based payment awards were $12.4 million and $8.4 million for the thirty-nine weeks ended September 30, 2018 and October 1, 2017, respectively.

7. 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 September 30, 2018, there were no purchases from this supplier and $2.7 million of purchases during the thirteen weeks ended October 1, 2017. During the thirty-nine weeks ended September 30, 2018 and October 1, 2017, purchases from this supplier were $2.6 million and $8.1 million, respectively. As of September 30, 2018, the Company had no accounts payable due to this vendor and as of December 31, 2017, the Company had recorded accounts payable of $0.7 million.

The Company’s former Executive Chairman of the Board, who retired from this position in February 2017, has been the chief executive officer, an equity investor, and lender to a technology supplier to the Company. During the thirteen weeks ended September 30, 2018 and October 1, 2017, purchases from this supplier and its predecessors were $1.8 million and $1.6 million, respectively. During the thirty-nine weeks ended September 30, 2018 and October 1, 2017, purchases from this supplier and its predecessors were $4.4 million and $5.2 million, respectively. As of September 30, 2018, and December 31, 2017, the Company had recorded accounts payable due to the supplier of $0.2 million and $0.1 million, respectively.

8. 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. The Company answered the complaint on September 28, 2017. On August 15, 2018, the Company reached an agreement in principle to settle these claims. The parties' settlement agreement will be presented to the court for approval. 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.

9. Stockholders' Equity

Share Repurchases

The following table outlines the common stock share repurchase programs authorized by the Company's board of directors from time to time, and the related repurchase activity and available authorization as of September 30, 2018.

Effective date	Expiration date	Amount authorized	Cost of repurchases	Authorization 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	$ 66,707	$ 283,293

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").

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Number of common shares acquired	719,004	3,249,204	8,411,575	9,136,468
Average price per common share acquired	$ 21.29	$ 22.16	$ 22.98	$ 21.01
Total cost of common shares acquired	$ 15,307	$ 72,000	$ 193,307	$ 192,000

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

10. 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		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Basic net income per share:				
Net income	$ 37,500	$ 31,486	$ 145,833	$ 118,741
Weighted average shares outstanding	126,855	134,320	129,572	136,063
Basic net income per share	$ 0.30	$ 0.23	$ 1.13	$ 0.87
Diluted net income per share:				
Net income	$ 37,500	$ 31,486	$ 145,833	$ 118,741
Weighted average shares outstanding - basic	126,855	134,320	129,572	136,063
Dilutive effect of equity-based awards:				
Assumed exercise of options to purchase shares	341	2,128	484	2,506
RSUs	175	122	193	124
RSAs	82	114	137	102
PSAs	174	86	151	65
Weighted average shares and equivalent shares outstanding	127,627	136,770	130,537	138,860
Diluted net income per share	$ 0.29	$ 0.23	$ 1.12	$ 0.86

For the thirteen weeks ended September 30, 2018, the computation of diluted net income per share does not include 0.7 million options and 0.1 million PSAs as those awards would have been antidilutive or were performance awards with performance conditions net yet deemed met. For the thirteen weeks ended October 1, 2017, the computation of diluted net income per share does not include 1.9 million options and 0.1 million PSAs as those awards would have been antidilutive or were unvested performance awards.

For the thirty-nine weeks ended September 30, 2018, the computation of diluted net income per share does not include 1.1 million options and 0.1 million PSAs those awards would have been antidilutive or were performance awards with performance conditions net yet deemed met. For the thirty-nine weeks ended October 1, 2017, the computation of diluted net income per share does not include 1.9 million options and 0.1 million PSAs as those awards would have been antidilutive or were unvested performance awards.

11. 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 five outstanding swaps was $250.0 million at September 30, 2018 and December 31, 2017, respectively, under which the Company pays a fixed rate and received 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 2018 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.

	As of September 30, 2018		As of December 31, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Interest rate swaps	Other Current Assets and Other Assets	$ 6,159	Other Accrued Liabilities and Long-term Liabilities	$ 1,064

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 ncome.

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Consolidated Statements of Income Classification				
Interest income (expense), net	$ 176	$ —	$ 115	$ —

12. Comprehensive Income

During the thirty-nine weeks ended October 1, 2017, the Company did not record accumulated other comprehensive income. The following table presents the changes in accumulated other comprehensive income for the thirty-nine weeks ended September 30, 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 $1,851	5,351
Total other comprehensive income	5,351
Balance at September 30, 2018	$ 4,567

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

13. Segments

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

In accordance with ASC 606, the following table represents a disaggregation of revenue for the thirteen and thirty-nine weeks ended September 30, 2018 and October 1, 2017.

	Thirteen Weeks Ended			
	September 30, 2018		October 1, 2017	
Perishables	$ 777,413	58.5%	$ 710,250	58.9%
Non-Perishables	551,696	41.5%	495,809	41.1%
Net Sales	$ 1,329,109	100.0%	$ 1,206,059	100.0%

	Thirty-nine Weeks Ended			
	September 30, 2018		October 1, 2017	
Perishables	$ 2,283,348	58.0%	$ 2,060,367	58.5%
Non-Perishables	1,654,650	42.0%	1,460,312	41.5%
Net Sales	$ 3,937,998	100.0%	$ 3,520,679	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.

14. Equity-Based Compensation

2013 Incentive Plan

The Company's board of directors adopted, and its equity holders approved, the Sprouts Farmers Market, Inc. 2013 Incentive Plan (the "2013 Incentive Plan"). The 2013 Incentive Plan became effective 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 stock-based and cash-based incentive compensation programs for its directors, officers and other team members, including RSUs, PSAs, and RSAs. On May 1, 2015, the Company's stockholders approved the material terms of the performance goals under the 2013 Incentive Plan for purposes of Section 162(m) of the Internal Revenue Code.

The aggregate number of shares of common stock that may be issued to team members and directors under the 2013 Incentive Plan may not exceed 10,089,072. Shares subject to awards granted under the 2013 Incentive Plan which are subsequently forfeited, expire unexercised or are otherwise not issued will not be treated as having been issued for purposes of the share limitation. As of September 30, 2018, there were 3,025,033 stock awards outstanding and 5,205,689 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 September 30, 2018, there were 130,643 options outstanding under the 2011 Option Plan.

Awards Granted

During the thirty-nine weeks ended September 30, 2018, the Company granted the following stock-based compensation awards:

Grant Date	RSUs	PSAs
March 2018	451,951	126,098
May 2018	54,913	2,756
August 2018	8,732	—
Total:	515,596	128,854
Weighted-average grant date fair value	$ 24.80	$ 25.10
Weighted-average exercise price	—	—

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 and vary depending on if they are time-based or performance-based.

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 in fiscal year 2016 vest annually over a period of three years. No options have been granted subsequent to 2016.

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 2015 are restricted shares that were subject to the Company achieving certain earnings per share performance targets, as well as additional time-vesting conditions. The fair value of PSAs is based on the closing price of the Company's common stock on the grant date. The performance conditions with respect to 2015 earnings per share targets were deemed to have been met, and all PSAs have vested. During the thirty-nine weeks ended September 30, 2018, 20,595 of the 2015 PSAs were vested, and during the thirty-nine weeks ended October 1, 2017, 21,050 of the 2015 PSAs were vested.

PSAs granted in fiscal year 2016 are restricted shares that are subject to the Company achieving certain earnings before interest and taxes ("EBIT") performance targets on an annual and cumulative basis over a three-year performance period, as well as additional time-vesting conditions. The EBIT target for each of the three years during the performance period is based on a percentage increase over the previous year's actual EBIT, with each annual performance tranche measured independently of the previous and next tranche. Cumulative performance is based on the aggregate annual performance and is measured against a cumulative performance target. Payout of the performance shares will either be 0% or range from 50% to 150% of the target number of shares granted, depending upon goal achievement. Although deemed unlikely to be met, if the performance conditions are met, the applicable number of performance shares is subject to cliff vesting on the third anniversary of the grant date (March 2019). The performance conditions with respect to 2016 and 2017 EBIT were not met.

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

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 (2021).

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.

Equity-based Compensation Expense

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Cost of sales, buying and occupancy	$ 251	$ 265	$ 827	$ 777
Direct store expenses	339	349	1,063	1,098
Selling, general and administrative expenses	2,453	3,471	9,783	8,450
Equity-based compensation expense before income taxes	3,043	4,085	11,673	10,325
Income tax benefit	(782)	(1,528)	(3,000)	(3,863)
Net equity-based compensation expense	$ 2,261	$ 2,557	$ 8,673	$ 6,462

The following equity-based awards were outstanding as of September 30, 2018 and December 31, 2017:

	As of	
	September 30, 2018	December 31, 2017
	(in thousands)	
Options		
Vested	1,816	4,226
Unvested	98	464
RSUs	694	449
PSAs	366	231
RSAs	182	353

As of September 30, 2018, total unrecognized compensation expense and remaining weighted average recognition period related to outstanding equity-based awards was as follows:

	Unrecognized compensation expense	Remaining weighted average recognition period
Options	$ 360	0.4
RSUs	11,895	1.8
PSAs	3,834	1.4
RSAs	2,343	1.4
Total unrecognized compensation expense at September 30, 2018	$ 18,432	

During the thirty-nine weeks ended September 30, 2018 and October 1, 2017, the Company received $21.1 million and $6.6 million, respectively, in cash proceeds from the exercise of options.

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

You should read the following discussion of our financial condition and results of operations 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 2017 fiscal year, February 22, 2018 with the Securities and Exchange Commission. All dollar amounts included below are in thousands, unless otherwise noted.

Business Overview

Sprouts Farmers Market operates as a healthy grocery store that specializes 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 313 stores in 19 states as of September 30, 2018, we are one of the largest specialty retailers of fresh, natural and organic food in the United States. As of October 29, 2018, we have grown to 315 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 September 30, 2018, we 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 intend to open approximately 30 new stores per year for the near term, and in 2018, we have opened 30 new stores through October 29, 2018.

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 education. We are committed to growing the Sprouts brand by supporting our stores, product offerings and corporate partnerships, including the expansion of innovative marketing and promotional strategies through print, digital and social media platforms.

Results of Operations for Thirteen Weeks Ended September 30, 2018 and October 1, 2017

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

	Thirteen weeks ended	
	September 30, 2018	October 1, 2017
Unaudited Quarterly Consolidated Statement of Income Data:		
Net sales	$ 1,329,109	$ 1,206,059
Cost of sales, buying and occupancy	946,734	859,650
Gross profit	382,375	346,409
Direct store expenses	281,365	250,191
Selling, general and administrative expenses	43,944	39,955
Store pre-opening costs	3,819	2,456
Store closure and other costs	461	803
Income from operations	52,786	53,004
Interest expense	(7,419)	(5,609)
Other income	—	162
Income before income taxes	45,367	47,557
Income tax provision	(7,867)	(16,071)
Net income	$ 37,500	$ 31,486
Weighted average shares outstanding	126,855	134,320
Diluted effect of equity-based awards	772	2,450
Weighted average shares and equivalent shares outstanding	127,627	136,770
Diluted net income per share	$ 0.29	$ 0.23

	Thirteen weeks ended	
	September 30, 2018	October 1, 2017
Other Operating Data:		
Comparable store sales growth	1.5%	4.6%
Stores at beginning of period	301	274
Closed	—	—
Opened	12	8
Stores at end of period	313	282

Comparison of Thirteen Weeks Ended September 30, 2018 to Thirteen Weeks Ended October 1, 2017

Net sales

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Net sales	$ 1,329,109	$ 1,206,059	$ 123,050	10%
Comparable store sales growth	1.5%	4.6%		

Net sales during the thirteen weeks ended September 30, 2018 totaled $1.3 billion, increasing 10% over the same period of the prior fiscal year. Sales growth was driven by strong performance in new stores opened and a 1.5% increase in comparable store sales. Comparable stores contributed approximately 90% of total sales for the thirteen weeks ended September 30, 2018 and approximately 87% for the same period of the prior fiscal year.

Cost of sales, buying and occupancy and gross profit

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Net sales	$ 1,329,109	$ 1,206,059	$ 123,050	10%
Cost of sales, buying and occupancy	946,734	859,650	87,084	10%
Gross profit	382,375	346,409	35,966	10%
Gross margin	28.77%	28.72%	0.05%	

Gross profit increased during the thirteen weeks ended September 30, 2018 compared to the thirteen weeks ended October 1, 2017 by $36.0 million, of which $35.4 million was a result of increased sales volume and $0.6 million related to increased margin rate. This improvement was primarily driven by higher margin rates for new stores opened in the current period partially offset by higher occupancy costs.

Direct store expenses

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Direct store expenses	$ 281,365	$ 250,191	$ 31,174	12%
Percentage of net sales	21.2%	20.7%	0.5%	

Direct store expenses for the thirteen weeks ended September 30, 2018 increased $31.2 million, including $24.5 million related to stores opened after October 1, 2017, and $6.7 million related to stores operating prior to the same period in 2017. Direct store expenses, as a percentage of net sales, increased 50 basis points. This deleverage is primarily driven by planned wage investments funded by the savings from the legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”) as well as increased healthcare costs and higher depreciation expense associated with new store and strategic initiatives.

Selling, general and administrative expenses

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Selling, general and administrative expenses	$ 43,944	$ 39,955	$ 3,989	10%
Percentage of net sales	3.3%	3.3%	—	

Selling, general and administrative expenses, as a percentage of sales, remained consistent during the thirteen weeks ended September 30, 2018 as compared to the thirteen weeks ended October 1, 2017. The $4.0 million increase in selling, general and administrative expenses primarily relates to increases in advertising, consulting and compensation expense in line with store growth and the Company's strategic initiatives, partially offset by lower bonus and stock-based compensation expense.

Store pre-opening costs

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Attributable to 2017 store openings	—	2,055	(2,055)	
Attributable to planned 2018 store openings	3,505	139	3,366	
Attributable to planned 2019 store openings	314	262	52	
Total store pre-opening costs	$ 3,819	$ 2,456	$ 1,363	55%
Percentage of net sales	0.3%	0.2%	0.1%	

Store pre-opening costs in the thirteen weeks ended September 30, 2018 included $3.5 million primarily related to 12 stores opening during the period and two additional stores planned to be open in 2018 and $0.3 million associated with stores expected to open in 2019. Store pre-opening costs in the thirteen weeks ended October 1, 2017 included $2.1 million related to opening 11 stores during the third and fourth quarter 2017 and $0.4 million associated with stores opened subsequent to 2017.

Store closure and other costs

Store closure costs for the thirteen weeks ended September 30, 2018 and October 1, 2017 are related to adjustments to the closed facility reserve primarily related to refinement of estimated subtenant income and other actual occupancy costs from original estimates.

During the third quarter 2018, we incurred $0.4 million in costs, net of estimated insurance recovery, primarily associated with Hurricane Florence which affected 24 stores in three states. Although physical damage was minimal, the stores incurred costs for hurricane preparation work, temporary closures and inventory loss.

During the third quarter of 2017, 14 of our stores were affected by hurricanes in three states. Although physical damage was minimal, the stores experienced loss of business due to temporary closures, inventory loss and additional expenses to clean up and power the stores. These costs, net of estimated insurance recovery, approximate $0.7 million in the thirteen weeks ended October 1, 2017.

Interest expense

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Long-term debt	$ 4,312	$ 2,305	$ 2,007	87%
Capital and financing leases	3,023	3,033	(10)	(0)%
Deferred financing costs	141	116	25	22%
Interest rate hedge and other	(57)	155	(212)	(137)%
Total Interest Expense	$ 7,419	$ 5,609	$ 1,810	32%

The increase in interest expense is due to the higher principal balance on long-term debt combined with slightly higher interest rates for the thirteen weeks ended September 30, 2018.

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	
	September 30, 2018	October 1, 2017
Federal statutory rate	21.0%	35.0%
Increase (decrease) in income taxes resulting from:		
State income taxes, net of federal benefit	4.9%	3.7%
Excess tax benefits from share based payments	(2.1)%	(0.5)%
Tax calculation method change	(5.7)%	—
Other, net	(0.8)%	(4.4)%
Effective tax rate	17.3%	33.8%

Income tax provision decreased to $7.9 million for the thirteen weeks ended September 30, 2018 from $16.1 million for the thirteen weeks ended October 1, 2017. Our effective income tax rate decreased to 17.3% in the thirteen weeks ended September 30, 2018 from 33.8% in the thirteen weeks ended October 1, 2017 primarily related to the effects of the Tax Act, a discrete rate benefit resulting from a tax calculation method change made in connection with finalizing the 2017 income tax return and the recognition of excess tax benefits related to the exercise of stock options.

Net income

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Net income	$ 37,500	$ 31,486	$ 6,014	19%
Percentage of net sales	2.8%	2.6%	0.2%	

Net income increased $6.0 million as a result of increased sales, due to strong new store performance and lower tax rate due to the Tax Act and tax accounting method change, partially offset by higher compensation expenses due to planned wage investments funded by the savings from the Tax Act.

Diluted earnings per share

	Thirteen weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Diluted earnings per share	$ 0.29	$ 0.23	$ 0.06	26%
Diluted weighted average shares outstanding	127,627	136,770	(9,143)	

The increase in diluted earnings per share of $0.06 was driven by higher net income and fewer diluted shares outstanding compared to the prior year, due primarily to the share repurchase program.

Results of Operations for Thirty-nine Weeks Ended September 30, 2018 and October 1, 2017

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

	Thirty-nine weeks ended	
	September 30, 2018	October 1, 2017
Unaudited Quarterly Consolidated Statement of Income Data:		
Net sales	$ 3,937,998	$ 3,520,679
Cost of sales, buying and occupancy	2,788,159	2,494,998
Gross profit	1,149,839	1,025,681
Direct store expenses	816,933	715,336
Selling, general and administrative expenses	128,828	110,312
Store pre-opening costs	9,414	10,055
Store closure and other costs	497	992
Income from operations	194,167	188,986
Interest expense	(20,028)	(15,447)
Other income	325	388
Income before income taxes	174,464	173,927
Income tax provision	(28,631)	(55,186)
Net income	$ 145,833	$ 118,741
Weighted average shares outstanding	129,572	136,063
Diluted effect of equity-based awards	965	2,797
Weighted average shares and equivalent shares outstanding	130,537	138,860
Diluted net income per share	$ 1.12	$ 0.86

	Thirty-nine weeks ended	
	September 30, 2018	October 1, 2017
Other Operating Data:		
Comparable store sales growth	2.0%	2.4%
Stores at beginning of period	285	253
Closed	—	—
Opened	28	29
Stores at end of period	313	282

Comparison of Thirty-nine Weeks Ended September 30, 2018 to Thirty-nine Weeks Ended October 1, 2017

Net sales

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Net sales	$ 3,937,998	$ 3,520,679	$ 417,319	12%
Comparable store sales growth	2.0%	2.4%		

Net sales during the thirty-nine weeks ended September 30, 2018 totaled $3.9 billion, increasing 12% over the same period of the prior fiscal year. Sales growth was primarily driven by strong performance in new stores opened and a 2.0% increase in comparable store sales. Comparable stores contributed approximately 89% of net sales for the thirty-nine weeks ended September 30, 2018 and approximately 87% for the same period of the prior fiscal year.

Cost of sales, buying and occupancy and gross profit

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Net sales	$ 3,937,998	$ 3,520,679	$ 417,319	12%
Cost of sales, buying and occupancy	2,788,159	2,494,998	293,161	12%
Gross profit	1,149,839	1,025,681	124,158	12%
Gross margin	29.20%	29.13%	0.07%	

Gross profit increased during the thirty-nine weeks ended September 30, 2018 compared to the thirty-nine weeks ended October 1, 2017 by $124.2 million, primarily as a result of increased sales volume due in part to the opening of 28 new stores and increased margin rate.

Direct store expenses

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Direct store expenses	$ 816,933	$ 715,336	$ 101,597	14%
Percentage of net sales	20.7%	20.3%	0.4%	

Direct store expenses for the thirty-nine weeks ended September 30, 2018 increased $101.6 million. Direct store expenses, as a percentage of net sales, increased 40 basis points. This deleverage is primarily driven by planned wage investments funded by the savings from the Tax Act as well as increased healthcare costs and depreciation expense associated with new store and strategic initiatives.

Selling, general and administrative expenses

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Selling, general and administrative expenses	$ 128,828	$ 110,312	$ 18,516	17%
Percentage of net sales	3.3%	3.1%	0.2%	

The increase in selling, general and administrative expenses primarily reflects increases in compensation expense, advertising and consulting costs, commensurate with store growth and strategic initiatives.

Store pre-opening costs

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Attributable to 2017 store openings	—	9,272	(9,272)	
Attributable to planned 2018 store openings	8,416	254	8,162	
Attributable to planned 2019 store openings	998	529	469	
Total store pre-opening costs	$ 9,414	$ 10,055	$ (641)	(6)%
Percentage of net sales	0.2%	0.3%	(0.1)%	

Store pre-opening costs in the thirty-nine weeks ended September 30, 2018 included $8.4 million primarily related to 28 stores opening during the period and two additional stores planned to be open in 2018 and $1.0 million associated with stores expected to open in 2019. Store pre-opening costs in the thirty-nine weeks ended October 1, 2017 included $9.3 million related to opening 32 stores during the year and $0.8 million associated with stores opened subsequent to 2017.

Store closure and other costs

Store closure costs for the thirty-nine weeks ended September 30, 2018 and October 1, 2017 are related to adjustments to the closed facility reserve primarily related to refinement of estimated subtenant income and other actual occupancy costs from original estimates.

During the third quarter 2018, we incurred $0.4 million in costs, net of estimated insurance recovery, primarily associated with Hurricane Florence which affected 24 stores in three states. Although physical damage was minimal, the stores incurred costs for hurricane preparation work, temporary closures and inventory loss.

During the third quarter of 2017, 14 of our stores were affected by hurricanes in three states. Although physical damage was minimal, the stores experienced loss of business due to temporary closures, inventory loss and additional expenses to clean up and power the stores. These costs, net of estimated insurance recovery, approximate $0.7 million in the thirty-nine weeks ended October 1, 2017.

Interest expense

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Long-term debt	$ 10,495	$ 5,919	$ 4,576	77%
Capital and financing leases	8,748	8,715	33	0%
Deferred financing costs	658	347	311	90%
Interest rate hedge and other	127	466	(339)	(73)%
Total Interest Expense	$ 20,028	$ 15,447	$ 4,581	30%

The increase in interest expense is due to the higher principal balance of long-term debt combined with slightly higher interest rates on our Former Credit Facility for the thirty-nine weeks ended September 30, 2018.

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:

	Thirty-nine weeks ended	
	September 30, 2018	October 1, 2017
Federal statutory rate	21.0%	35.0%
Decrease in income taxes resulting from:		
State income taxes, net of federal benefit	4.9%	3.7%
Excess tax benefits from share based payments	(7.1)%	(4.9)%
Tax calculation method change	(1.5)%	—
Other, net	(0.9)%	(2.1)%
Effective tax rate	16.4%	31.7%

Income tax provision decreased to $28.6 million for the thirty-nine weeks ended September 30, 2018 from $55.2 million for the thirty-nine weeks ended October 1, 2017. Our effective income tax rate decreased to 16.4% in the thirty-nine weeks ended September 30, 2018 from 31.7% in the thirty-nine weeks ended October 1, 2017 primarily related to the effects of the Tax Act, the recognition of excess tax benefits related to the exercise of stock options and a discrete rate benefit resulting from a tax calculation method change made in connection with finalizing the 2017 income tax return.

Net income

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Net income	$ 145,833	$ 118,741	$ 27,092	23%
Percentage of net sales	3.7%	3.4%	0.3%	

Net income increased $27.1 million as a result of increased sales, due to strong new store performance and lower tax rate due primarily to the Tax Act, partially offset higher compensation expenses due to planned wage investments funded by the savings from the Tax Act.

Diluted earnings per share

	Thirty-nine weeks ended			
	September 30, 2018	October 1, 2017	Change	% Change
Diluted earnings per share	$ 1.12	$ 0.86	$ 0.26	30%
Diluted weighted average shares outstanding	130,537	138,860	(8,323)	

The increase in diluted earnings per share of $0.26 was driven by the increase in net income as well as 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 leases are capitalized as part of the ROIC calculation to control for differences in capital structure between us and our competitors. Capitalized operating lease interest represents this adjustment to NOPAT and is calculated by the hypothetical capitalization of our operating leases, using eight times our trailing twelve months rent expense and an interest rate factor of seven percent. Operating leases are determined as the trailing twelve months' rent expense times a factor of eight. 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	
	September 30, 2018	October 1, 2017
	(dollars in thousands)	
Net income (1)	$ 185,531	$ 135,745
Income Tax Adjustment for Tax Act (2)	(21,266)	—
Interest expense, net of tax (3)	20,534	11,770
Net operating profit after tax (NOPAT)	$ 184,799	$ 147,515
Total rent expense, net of tax (3)	104,958	78,113
Estimated depreciation on capitalized operating leases, net of tax (3)	(46,182)	(34,370)
Estimated interest on capitalized operating leases, net of tax (3) (4)	58,776	43,743
NOPAT, including effect of capitalized operating leases	$ 243,575	$ 191,258
Average working capital	21,536	15,093
Average property and equipment	738,424	641,451
Average other assets	573,946	574,281
Average other liabilities	(192,287)	(149,039)
Average invested capital	$ 1,141,619	$ 1,081,786
Average estimated asset base of capitalized operating leases	1,053,271	930,645
Average invested capital, including the effect of capitalized operating leases	$ 2,194,890	$ 2,012,431
ROIC	16.2%	13.6%
ROIC, including the effect of capitalized operating leases	11.1%	9.5%

(1) Net income amounts represent total net income for past four trailing quarters.
(2) $18.7 million income tax benefit related to the Tax 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, see Note 6, "Income Taxes."
(3) Net of tax amounts are calculated using the effective tax rate for the periods presented.
(4) Interest on capitalized leases is calculated as the trailing four quarters' rent expense multiplied by eight and by a seven 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):

	Thirty-nine weeks ended	
	September 30, 2018	October 1, 2017
Cash, cash equivalents and restricted cash at end of period	$ 17,831	$ 18,892
Cash flows from operating activities	$ 235,466	$ 258,969
Cash flows used in investing activities	$ (148,432)	$ (158,429)
Cash flows used in financing activities	$ (88,682)	$ (94,113)

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” 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 decreased $23.5 million to $235.5 million for the thirty-nine weeks ended September 30, 2018 compared to $259.0 million for the thirty-nine weeks ended October 1, 2017. The decrease in cash flows from operating activities is primarily a result of changes in working capital, partially offset higher noncash depreciation and amortization.

Cash flows provided by/(used in) operating activities from changes in working capital was ($46.5) million in the thirty-nine weeks ended September 30, 2018, compared to $24.5 million in the thirty-nine weeks ended October 1, 2017.

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 $148.4 million, and $158.4 million, for the thirty-nine weeks ended September 30, 2018 and October 1, 2017, respectively.

We expect capital expenditures to be in the range of $160 - $165 million in fiscal 2018, 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 $88.7 million for the thirty-nine weeks ended September 30, 2018 compared to $94.1 million for the thirty-nine weeks ended October 1, 2017. During the thirty-nine weeks ended September 30, 2018, cash flows used in financing activities primarily consisted of $193.3 million for stock repurchases, partially offset by $87.0 million of net borrowings on our credit facilities, and $21.1 million in proceeds from the exercise of stock options.

During the thirty-nine weeks ended October 1, 2017, cash flows used in financing activities primarily consisted of $192.0 million for stock repurchases, partially offset by $94.0 million of net borrowings on the Former Credit Facility, and $6.6 million in proceeds from the exercise of stock options.

Long-Term Debt and Credit Facilities

Long-term debt increased $87.0 million to $435.0 million as of September 30, 2018, compared to December 31, 2017. The increase is due to net borrowings under our credit facilities primarily used for our share repurchase programs. See Note 4, “Long-Term Debt” 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 September 30, 2018.

Effective date	Expiration date	Amount authorized	Cost of repurchases	Authorization 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	$ 66,707	$ 283,293

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 credit facilities to assist with the repurchase programs (see Note 4, “Long-Term Debt” of our unaudited consolidated financial statements).

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	September 30, 2018	October 1, 2017	September 30, 2018	October 1, 2017
Number of common shares acquired	719,004	3,249,204	8,411,575	9,136,468
Average price per common share acquired	$ 21.29	$ 22.16	$ 22.98	$ 21.01
Total cost of common shares acquired	$ 15,307	$ 72,000	$ 193,307	$ 192,000

Shares purchased under our repurchase programs were subsequently retired.

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 2034.

The following table summarizes our contractual obligations as of September 30, 2018, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
			(in thousands)		
$700.0 million Credit Agreement (1)	$ 435,000	—	—	$ 435,000	—
Interest payments on $700.0 million Credit Agreement (2)	69,831	16,063	33,305	20,463	—
Capital and financing lease obligations(3)	123,421	16,444	31,692	26,810	48,475
Operating lease obligations(3)	1,690,376	155,489	334,592	310,553	889,742
Totals	$ 2,318,628	$ 187,996	$ 399,589	$ 792,826	$ 938,217

(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 “4-5 Years” column and discussed in the financing activities section above. See Note 4, “Long-Term Debt” 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 September 30, 2018 and based on LIBOR rates in effect at the time of this report, net of interest rate swaps.

(3) Represents estimated payments for capital and financing and operating lease obligations as of September 30, 2018. Capital and financing lease obligations and operating lease obligations are presented gross without offset for subtenant rentals. We have subtenant agreements under which we will receive $1.5 million for the period of less than one year, $2.7 million for years one to three, $2.1 million for years four to five, and $2.2 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 31, 2017, and for which there have not been material changes since that filing through September 30, 2018.

Off-Balance Sheet Arrangements

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

Impact of Inflation and Deflation

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

Food inflation and deflation is affected by a variety of factors, including among other things weather conditions, product supply and geopolitical conditions (including tariffs), and our determination of whether to pass on the effects of inflation or deflation to our customers is made in conjunction with our overall pricing and marketing strategies, 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 inflation or deflation 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 equity-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 thirty-nine weeks ended September 30, 2018. 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 31, 2017.

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.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As described in Note 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 $435.0 million principal outstanding under our Amended and Restated Credit Agreement as of September 30, 2018, each hundred basis point change in LIBOR would result in a change in interest expense by $4.4 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 December 31, 2017 and September 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 $435.0 million principal outstanding under our Amended and Restated Credit Agreement as of September 30, 2018, each hundred basis point change in LIBOR would result in a change in interest expense by $1.9 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 11, “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 Chief Executive Officer (our principal executive officer) and our Chief Financial Officer (our principal financial officer), as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures under the Exchange Act as of September 30, 2018, the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the quarterly period ended September 30, 2018, there were no changes in our internal controls over financial reporting that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

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

Securities Action

On March 4, 2016, a complaint was filed in the Superior Court for the State of Arizona against 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 15, 2018, we reached an agreement in principle to settle these claims. The parties' settlement agreement will be presented to the court for approval. If approved by the court, the settlement will be funded from our directors and officers 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 (referred to as "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 (referred to as "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. Subsequent to the stay, it remains to be seen what strategy plaintiffs will pursue following *Epic Systems*. 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 accepted public comments on the proposed regulation until August 30, 2018, and expects that the proposed regulation, if finalized, could be effective as early as January 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, until further order.

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 31, 2017.

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 thirty-nine weeks ended September 30, 2018.

Period (1)	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
July 2, 2018 - July 29, 2018	215,795	$ 21.25	215,795	$ 294,023,000
July 30, 2018 - August 26, 2018	503,209	$ 21.31	503,209	$ 283,293,000
August 27, 2018 - September 30, 2018	—	—	—	$ 283,293,000

(1) Periodic information is presented by reference to our fiscal periods during the third quarter of fiscal year 2018.

Item 6. Exhibits.

Exhibit Number	Description
10.1†	Distribution Agreement, dated as of July 18, 2018, by and between SFM, LLC dba Sprouts Farmers Market and KeHE Distributors, LLC
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
†	Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a confidential treatment request submitted separately to the SEC pursuant to Rule 406 under the Securities Act.

SIGNATURES

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

SPROUTS FARMERS MARKET, INC.

Date: November 1, 2018

By: */s/ Bradley S. Lukow*
Name: Bradley S. Lukow
Title: Chief Financial Officer
(Principal Financial Officer)

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Section 2: EX-10.1 (EX-10.1)

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

Exhibit 10.1

Execution Version

DISTRIBUTION AGREEMENT

This Distribution Agreement ("***Agreement***") is made effective as of July 18, 2018 (the "***Effective Date***"), by and between SFM, LLC dba Sprouts Farmers Market ("***SFM***"), a Delaware limited liability company, and KeHE Distributors, LLC ("***KeHE***"), a Delaware limited liability company. SFM and KeHE shall each be referred to as a "Party" and together as the "Parties". All capitalized terms herein shall have the meanings set forth in Schedule 1 hereto. The exhibits and schedules hereto are an integral part of this Agreement and are deemed incorporated by reference herein.

RECITALS

WHEREAS, SFM is engaged in the sale of natural and organic products in brick and mortar stand-alone retail stores (the "***SFM Stores***"). Its operations include retail stores and distribution centers.

WHEREAS, KeHE provides the distribution of natural and organic, specialty, and other products for sale at retail. KeHE also provides various customized support services to retailers and food manufacturers related to the distributions of these products.

WHEREAS, the Parties, through KeHE's wholly-owned subsidiary Nature's Best, are parties to that certain Amended and Restated Distribution Agreement dated August 13, 2014, as amended (the "***NB Agreement***") and that certain Deli, Cheese, and Bakery Distribution Agreement dated February 13, 2016 (the "***Deli Agreement***").

WHEREAS, the NB Agreement expired June 1st, 2018, and the Parties have agreed to continue the business relationship under the terms and conditions set forth herein. The Parties desire to enter into this Agreement to set forth the terms upon which KeHE will sell and distribute the Products to SFM Stores and provide the Services described herein.

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

SECTION 1. – SUPPLY AND DISTRIBUTION

1.1. Term. This Agreement shall have a term of seven (7) years commencing on the Effective Date and continuing until July 18, 2025, unless terminated sooner as provided herein (the "***Term***"). All sales of Products by KeHE to SFM prior to the Effective Date shall be governed by the NB Agreement and products distributed by KeHE to SFM under the Deli Agreement shall be governed by such.

1.2. Products and Primary Supplier.

a) *Purchase of Products*. SFM agrees to purchase from KeHE, and KeHE agrees to sell to SFM, the Products for all existing and new SFM Stores **[***]**. Notwithstanding the foregoing, **[***]**. The Parties agree to work together in good faith towards **[***]**. The Parties will mutually agree on a transition plan to distribute Product **[***]** per this Agreement.

b) *Primary Supplier*. During the Term of this Agreement KeHE will be the Primary Supplier for all Products purchased by SFM for SFM Stores. **[***]** The Parties will work together in good faith to review the information, including but not limited to, volume and frequency, **[***]**.

c) *Exceptions to Primary Supplier Status*. The Primary Supplier status may be temporarily suspended if **[***]**. During such times the Parties will establish guidelines for limited purchases from other distributors and resume and return such purchases to KeHE once KeHE is able to supply the Products; **[***]**. Notwithstanding the foregoing, **[***]**.

d) *Vendor Sales*. In the event SFM orders Product from KeHE that KeHE is unable to supply or supplies in a limited quantity **[***]**.

e) **[***]**.

f) *Projected Purchases*. The table below sets forth estimated Purchases by SFM on a Fiscal Year basis ("***Projected Annual Purchases***"), which are measured **[***]** The Projected Annual Purchases do not include purchases attributable to **[***]** and are intended to be a guideline of all Purchases under this Agreement and **[***]**; however, its variation shall be subject to **[***]**.

g) *Product Requests*. KeHE will stock all Products on the APL. The Parties shall work together to define a healthy and productive Product mix on the APL.

h) *Regional Products*. Products ordered for a specific geographic location (e.g., a local product for a specific region or group of stores) will be included in the APL and the Parties will work in good faith to ensure there are reasonable aggregate Turns for such Products in the relevant DC.

i) *Product Discontinuation*. SFM will provide KeHE with no less than **[***]** days' notice prior to discontinuing any Products purchased from KeHE. Following such notice, the Parties shall use commercially reasonable efforts to reduce inventory levels of such Products, such as mark down strategies.

j) **[***]**

k) *New Products*. KeHE will communicate to SFM any new Products available through KeHE in order for SFM to purchase such new Products, if so desired by SFM, and will provide SFM with information related to high volume new Products upon request from SFM.

SECTION 2. – SUPPORT SERVICES, PERSONNEL, DELIVERY, AND ORDERING

2.1. Support Services. KeHE will provide the Services and will maintain an adequate account management support structure with personnel with sufficient education and experience to provide such Services. KeHE shall maintain **[***]**, or as otherwise agreed to by the Parties from time to time. The Parties agree to remain flexible in these requirements and to work in good faith to address any changes in the relationship, provided any material changes must be mutually agreed upon by the Parties in writing. All KeHE employees are subject to the Visiting Vendor Employee Agreement dated August 19, 2015. The Parties will work in good faith to review service levels and individual performance of the account management team, **[***]**, with the understanding that KeHE is ultimately responsible for all employment-related decisions for its employees. As part of the Services, KeHE shall provide SFM with the reports listed in **Exhibit E** at the frequency set forth therein and other ad hoc reports as reasonably requested by SFM from time to time.

2.2. Delivery and Transportation Services.

a) *Direct Store Delivery*. KeHE will deliver the Products direct to all SFM Stores. SFM Store will receive no less than **[***]** (with some mutually agreed-upon exceptions based on SFM Store volume of Purchases or specific SFM Store logistical needs) in accordance with the mutually agreed upon Delivery Windows, and the Parties will work together to ensure a mutually beneficial optimal **[***]** number of deliveries (and schedule for those deliveries).

b) *Cross Dock and SFM Pick-Up*. SFM may request KeHE to (i) deliver Products to SFM's warehouses to allow SFM to coordinate delivery to SFM Stores ("***Cross-Dock***"), or (ii) make Products available at KeHE's DCs for SFM to pick-up, deliver to an SFM distribution center and subsequently deliver to an SFM Stores ("***SFM Pick-Up***"). All such Cross-Dock and SFM Pick-Up Products will be segmented and palletized at KeHE's DC, clearly designating the corresponding SFM Store to which those Products are destined. Cross-Dock and SFM Pick-Up pricing and requirements are set forth in **Exhibit B**.

2.3. Ordering and Shelf Maintenance. SFM will be responsible for all ordering, stocking, rotating, and shelf maintenance for the Products. Current practices as of the Effective Date for order frequency and cut-off times will continue unless otherwise agreed by the Parties. KeHE will continue to **[***]**.

2.4. Credits and Credit Policy.

a) **[***]** Except as provided in the **[***]**, KeHE shall not be responsible for any **[***]**. KeHE agrees to **[***]**.

b) **[***]** Any credits agreed to by KeHE **[***]**. **[***]** shall strictly follow the **[***]** and SFM agrees to work in good faith to reduce any such credits to the extent practical and ensure that all credits are supportable. KeHE will provide reporting as necessary to address outlier store credit results as described in **Exhibit E** hereto.

c) *Customer Return Credits*. KeHE will use commercially reasonable efforts to facilitate credit to SFM by Vendors for customer returns. KeHE will have no obligation **[***]**. Credits for customer returns will be credited to SFM every Fiscal Period.

2.5. KeHE Warehouse Spoilage Initiative.

a) *Spoilage*. SFM will **[***]**, provided they are included in the reports set forth in Section 2.5(b) below.

b) *Spoilage Improvement and Reporting*. The Parties will collaborate to improve KeHE's net DC Product spoilage relating to SFM Products to be consistently **[***]**.

c) *At-Risk Products*. The Parties agree to limit spoilage risk by working in good faith to move any excess product through to SFM Stores with **[***]** to drive sales of at-risk Products at SFM Stores. KeHE agrees to **[***]**, and SFM agrees to **[***]**.

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

SECTION 3. – PRODUCT PRICING

3.1. Mark-Up. SFM shall buy Products from KeHE on a "cost plus" basis, meaning that the pricing for Product shall be equal to **[***]**

[***]

* The Mark-Up does not include **[***]**.

3.2. Changes to **[***]** for the Products may be changed from time-to-time with a minimum of **[***]** prior written notice. This includes Private Label Products, and SFM will require Private Label Product Vendors to give KeHE no less than **[***]**. Such **[***]** will become part of this Agreement and **[***]**. Notwithstanding the foregoing, for any commodity-driven price changes (e.g. bulk and some refrigerated Products), the Parties will mutually discuss the price change implementation date, which may be earlier than the foregoing **[***]** notice period; provided **[***]**.

3.3. **[***]**, which is subject to review and adjustment as set forth in **Exhibit B** hereto, **[***]**. Any adjustment to the **[***]** made in accordance with **Exhibit B** shall be reflected in the **[***]**.

3.4. Business Model Assumptions. The Parties understand and agree that the material business terms set forth in this Agreement are intended to create a mutually beneficial business relationship and KeHE used certain assumptions set forth on Exhibit C (the "***Assumptions***") to form a basis for its negotiations. **[***]**

SECTION 4. – PAYMENT AND PAYMENT TERMS

4.1. Payment Terms. Payment terms shall be net **[***]** via Automated Clearing House ("***ACH***") from the date of KeHE's invoice. SFM will initiate and process payments to KeHE **[***]** (excluding weekends and bank holidays) and provide KeHE with an excel file detailing **[***]**. Invoices for new SFM Stores will be paid under the same payment terms. SFM will only take deductions from payments due to KeHE for **[***]** against open accounts payable based on the net **[***]** ACH terms. The Parties agree to work in good faith to promptly remediate any issues that may cause delays with payments processed by SFM to KeHE for any undisputed invoices.

4.2. **[***]**

a) **[***]**. KeHE agrees to use commercially reasonable efforts to collect **[***]**. SFM acknowledges that KeHE is acting as **[***]**, and SFM shall remain responsible **[***]**. SFM will continue to process **[***]** under the processing schedule as of the Effective Date and provide a **[***]** (in excel or other mutually acceptable format) to KeHE via email (or other agreed upon method) showing such processed **[***]**. SFM will **[***]** will be processed only with KeHE's prior approval. The Parties will jointly establish guidelines for collections and Fiscal Period reporting by KeHE to SFM (the "***Aging Report***") and SFM will work collaboratively with KeHE **[***]**.

b) **[***]**. SFM will not **[***]** unless it has sufficient documentation of the **[***]**. KeHE may notify SFM where there are **[***]**, and in such instances SFM will not **[***]** unless approved by KeHE.

SECTION 5. – KEHE DISTRIBUTION CENTERS

5.1. Existing Distribution Centers. KeHE shall maintain DC's servicing SFM **[***]**. If KeHE elects to move a DC or open a New DC in the same geographic area as an existing DC (as opposed to being required to open a New DC in a new geographic area pursuant to Section 5.2), **[***]**.

5.2. New Distribution Centers.

a) *Transportation-Related New DCs*. SFM will provide KeHE visibility to its projected stores and volume in a certain region **[***]**. If SFM projects it will have more than **[***]** in a certain geographic area, and/or **[***]** from the SFM Stores in such area, serviced from an existing DC that is **[***]** miles away or more from such SFM Stores, then SFM shall notify KeHE accordingly and, **[***]**, KeHE will **[***]**.

b) *Capacity-Related New DCs*. KeHE may open New DCs to relieve capacity constraints, and/or to lower transportation costs. **[***]**.

5.3. Standards for DCs. KeHE will maintain and operate all DCs in accordance with all applicable laws, in compliance with industry standards (including but not limited to industry sanitation standards), and in all material respects in accordance with KeHE's warehousing and delivery standards, which will be made available for review upon request by SFM. Such DCs shall have the operational systems required to support the obligations of KeHE as set forth in this Agreement, and all have adequate capacity to order, store and deliver Products in accordance with the terms of this Agreement and in the amounts contemplated by SFM. All the DCs shall have sufficient security measures in place prior to receipt of Products for SFM to ensure that such Products are not tampered with or adulterated in any manner, and that all such Products shall be maintained at temperatures and other storage conditions necessary to preserve the freshness and integrity of the Products. SFM may inspect the KeHE DCs serving SFM and inventory therein during normal business hours upon no less than five (5) business days advance notice to the designated KeHE personnel and no more than two (2) times per year per DC and provided any such inspection shall not impair or impede the business operations of the center.

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

SECTION 6. – PRIVATE LABEL PRODUCTS

6.1. Private Label. SFM will negotiate directly with the manufacturer for all Private Label Products. KeHE will provide the purchasing and distribution functions. KeHE shall not sell, distribute or donate any Private Label Products to any third party without SFM's prior written approval. KeHE shall not dispose of any Private Label Products except in accordance with SFM's reasonable written instructions which SFM may modify from time to time. **[***]** The Mark-Up attributed to Private Label Products assumes that **[***]**.

6.2. Stocking of Private Label. KeHE agrees to stock **[***]**. Continuing current practice, when SFM's sales of Private Label Products in new regions is insufficient for an efficient direct delivery by the Vendor to the KeHE DC, or where SFM requests KeHE transfers Private Label Products from one KeHE DC to another DC, **[***]**. Within 60 days from the Effective Date, the Parties will review in good faith the methodology for calculating **[***]** and mutually agree to any changes necessary to such methodology. The Parties will periodically review this methodology.

6.3. Code Date Management. The following shall be the Private Label Products inventory management practices the Parties will continue to employ:

a) KeHE shall provide the respective SFM category managers a dedicated periodic inventory report showing code dates and time remaining for all Private Label Product inventories in each facility, as provided in **Exhibit E**. This provides the opportunity for the Parties to **[***]**. SFM will be responsible for **[***]** for Private Label products in KeHE's inventory, except to the extent caused by KeHE's negligence, such as buying errors or excessive over-purchasing by KeHE and any such responsibility by KeHE has been approved, when deemed necessary, by both Parties at the Vice President level. Additionally, in the event KeHE fails to notify SFM of a Private Label Product's code date status at least **[***]** for non-perishables and **[***]** for perishables prior to their code date, or at an earlier agreed-upon timeframe for items with shorter shelf-life, resulting in the Private Label item being discarded due to it reaching the end of its code date, **[***]**.

b) In the event Private Label Products inventory is required to be discarded, KeHE shall remove the Product from inventory based on agreed-upon code date parameters, and **[***]**. Notwithstanding the foregoing, KeHE shall notify SFM prior to discarding any Product and SFM, at its sole expense, shall reserve the right to coordinate its disposal or donation to a local food bank of their choice, provided the timing for such disposal or donation is reasonable.

c) KeHE will communicate a code date policy to Private Label Product Vendors consistent with KeHE's code date policy for Branded Product Vendors, and SFM agrees to use commercially reasonable efforts to require all Private Label Product Vendors to comply with such code date policy. The Parties will work in good faith to seek reimbursement from Private Label Product Vendors for spoilage that result from failure to comply with the code date policy.

6.4. **[***]**.

a) **[***]**. The respective SFM department category managers will work in good faith with the KeHE team managing private label for SFM in order to proactively address Private Label Products with **[***]**.

b) **[***]**. In the event any Private Label Products do not maintain the **[***]**, will be reconciled at the close of the Fiscal Quarter as part of the Quarterly Reconciliation. **[***]** upon approval of both Parties at a Vice President or above level.

SECTION 7. – [***]

7.1. **[***]**

7.2. Quarterly Reconciliation of **[***]**.

a) *Reporting*. KeHE will use commercially reasonable efforts to provide reporting to SFM related to the **[***]** if reasonably practical, following the end of each SFM's Fiscal Period **[***]** if reasonably practical, following the close of each of SFM's Fiscal Quarter **[***]**.

b) *Reconciliation and Rebate*. The Parties will review and aggregate the results of each of the **[***]** (the "***Quarterly Reconciliation***") no later than 10 days following delivery of the **[***]**. Any Party owing the other any amounts as part of the **[***]**. The Parties will work together in good faith to improve the reporting timelines of these reports, as applicable.

7.3. **[***]** Review. If the Parties determine that information and assumptions used to determine **[***]**, the Parties will work in good faith to adjust **[***]**.

SECTION 8. – [***]

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

SECTION 9. – PERFORMANCE

9.1. Fill Rate. KeHE will **[***]**. KeHE shall report on the Fill Rate measurement, calculation and performance on a Fiscal Period basis as set forth on **Exhibit E**, **[***]**. Fill Rate calculations at the DC level shall only be used to determine if there are any localized DC Fill Rate issues which KeHE agrees to use commercially reasonable efforts to remediate. Both Parties acknowledge that Fill Rate Uncontrollable Factors shall occur from time to time that may affect the Fill Rate. KeHE shall provide SFM all supporting documentation regarding Fill Rate Uncontrollable Factors upon reasonable request. SFM shall have the ability to review and audit the Fill Rate calculation at any time during the ordinary course of business with reasonable notice. Any changes to the practices for how the Fill Rate is calculated or what are considered Fill Rate Uncontrollable Factors as of the Effective Date will be mutually agreed to by the Parties.

a) **[***]**

b) *New DCs*. **[***]**, and KeHE will provide separate reporting of Fill Rates on an individual basis for such DCs on the same cadence, and KeHE will use commercially reasonable efforts to **[***]**.

c) *Fill Rate* **[***]**. If the average Fill Rate falls below **[***]**, SFM may provide notice to KeHE of same (the "***Fill Rate Deficiency Notice***"). KeHE shall then have a period of **[***]** to cure such deficiency (i.e., bring it back to **[***]**) from the date of such Fill Rate Deficiency Notice (measured as **[***]**) (the "***Fill Rate Cure Period***"). If after the Fill Rate Cure Period the Fill Rate is still **[***]**, KeHE will start another Fill Rate Cure Period to remedy such deficiency. This process will repeat itself until KeHE is able to bring the Fill Rate **[***]** at the end of any Fill Rate Cure Period **[***].**

9.2. On Time Delivery. KeHE will utilize commercially reasonable efforts to maintain an On-Time Delivery performance rate of **[***]** for all deliveries to SFM Stores, measured **[***]** (the "***OTP Rate***"). Any Split Orders that are delivered more than **[***]** outside of the Delivery Windows will be considered late and included in the OTP Rate calculation. Split Orders shall not comprise **[***]** orders during any Fiscal Period. KeHE shall report on the **[***]**. The Parties agree and understand that Delivery Uncontrollable Factors shall occur from time to time that may affect the OTP Rate. **[***]**, as mutually agreed in good faith by the Parties. KeHE shall provide SFM all supporting documentation that created such Delivery Uncontrollable Factors upon reasonable request. Delivery Uncontrollable Factors shall be the exception and not the rule for calculating the OTP Rate. SFM shall have the ability to review and audit the OTP Rate calculation at any time during the ordinary course of business with reasonable notice.

a) **[***]**. During any Fiscal Period that the OTP Rate for any particular DC is not met, KeHE will **[***]**

b) **[***]**

c) *On-Time* **[***]**. If the aggregate OTP Rate for all DCs combined is below **[***]** in any consecutive **[***]** period, taking into account any Delivery Uncontrollable Factors, SFM may provide notice to KeHE of same (the "***OTP Deficiency Notice***"). KeHE shall then have a cure period of **[***]** ("***OTP Cure Period***") to remedy such deficiency (i.e., bring it back to **[***]** or above) from the date of the OTP Deficiency Notice. **[***]**

SECTION 10. – TERMINATION

10.1. Termination. In the event of any of the following events (each considered ***"Cause"***), the non-breaching Party may terminate this Agreement immediately, subject to the Transition Period, by providing written notice to the other Party:

a) If the other Party breaches any of its obligations under the Agreement and fails to cure such breach after **[***]** prior written notice of the breach by the non-breaching Party, or if the breach can be cured, but cannot be cured within **[***]**, fails to commence diligent effort to cure the breach within **[***]** and complete such cure within 90 days. Notwithstanding the foregoing, no further notice or cure period shall be required for either Party to terminate this Agreement for the failure of either Party to make undisputed payments required under this Agreement within 15 days following written notice.

b) If the other Party becomes insolvent, admits in writing its insolvency, commences or has filed against it a bankruptcy, reorganization, liquidation or insolvency proceeding, or if any received, trustee, or liquidator is appointed to take possession of such Party's assets.

c) If the other Party **[***]**.

d) KeHE may terminate to the extent **[***]**.

e) SFM may terminate if **[***]**.

f) SFM may terminate as set forth in **[***]**.

10.2. Obligations on Termination. Following expiration or termination of this Agreement for any reason, SFM will **[***]**. SFM shall only be responsible for **[***]**.

10.3. Transition Period. If either Party exercises its right to terminate for Cause, both Parties agree to work diligently and in good faith to develop a transition plan for a period of **[***]** (the "***Transition Period***"). During the Transition Period all terms under this Agreement shall continue in full force and effect, including but not limited to the Mark-Up, Purchase volumes, service levels regarding distribution of Product and credits provided hereunder.

a) The Transition Period may be extended for an additional **[***]** by mutual agreement of the Parties. During such extension the Primary Supplier status requirement in Section 1.2(b) and the Mark-Up shall be revisited by the Parties in good faith and shall be subject to adjustment by mutual agreement of the Parties to allow for further wind down costs for both Parties.

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

SECTION 11. – [***]

SECTION 12. – TITLE, WARRANTY, INDEMNITY

12.1. Title, Risk of Loss. For Products delivered by KeHE, title to the Products, and all risk of loss shall pass to SFM upon **[***]**. For Products **[***]**, title to the Products, and all risk of loss shall pass to SFM **[***]**.

12.2. DISCLAIMER OF WARRANTY. EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT, KEHE MAKES NO EXPRESS OR IMPLIED WARRANTIES IN CONNECTION WITH THE SALE OF THE PRODUCTS, INCLUDING ANY EXPRESS OR IMPLIED WARRANTY OR MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. Notwithstanding the foregoing, KeHE represents and warrants that it is KeHE's practice to obtain warranties from its Vendors, including warranties as to compliance with laws, that the products have not been adulterated. KeHE agrees to pass on to SFM any Product warranties, indemnifications, or other protections supplied by the Vendor thereof to the extent allowed by law.

12.3. Indemnification.

a) *Indemnification by KeHE*. KeHE agrees to indemnify, defend, and hold harmless SFM, and its subsidiaries and affiliates, and their employees, officers, directors, members, shareholders, and agents (collectively, the "***SFM Indemnitees***") from any and all third party claims, demands, threats, suits, proceedings, damages, liabilities or expenses (including reasonable attorney's fees) ("***Claims***") arising from or in connection with any allegation that any Product has directly or indirectly, in whole or in part: (i) given rise to any illness or injury to any person or animal, or any damage to property; (ii) has violated any applicable federal, state, local or other law, rule or regulation, including without limitation any regulations of the Food and Drug Administration or the Consumer Product Safety Commission or other regulations enacted for the purposes of consumer protection; (iii) is not merchantable or fit for its intended purpose; or (iv) is in any way defective or deficient in quality, labeling, packaging or manufacture. KeHE also agrees to indemnify, defend and hold harmless the SFM Indemnitees from any Claims arising out of the performance (or failure to perform) by KeHE of its obligations under this Agreement. The foregoing notwithstanding, KeHE shall not be liable for any Claims arising out of the negligence or willful misconduct of SFM or the SFM Indemnitees. Further, KeHE shall not be liable for Claims related to the purchase or sale of SFM's Private Label Products except to the extent caused by KeHE's negligence in handling, manipulation, storage, treatment or transportation of the Private Label Products or donation or disposal of the Private Label Products by KeHE in breach of the obligation of this Agreement (a "***KeHE Private Label Claim***").

b) *Indemnification by SFM*. SFM agrees to indemnify, defend, and hold harmless KeHE, its subsidiaries and affiliates, and their employees, officers, directors, members, shareholders, and agents (collectively, the "***KeHE Indemnitees***") from any and all Claims arising out of: (i) the performance (or failure to perform) by SFM of its obligations under this Agreement; (ii) the negligence or willful misconduct of SFM, its agents or employees; or (iii) Claims related to the purchase or sale of SFM's Private Label Products, except any KeHE Private Label Claims. The foregoing notwithstanding, SFM shall not be liable for any Claims arising out of the negligence or willful misconduct of KeHE or the KeHE Indemnitees.

c) *Indemnification Procedures*. If any Claim is alleged or asserted against a party entitled to indemnification under this Agreement (the "***Indemnified Party***"), notice thereof shall be given to the other party (the "***Indemnifying Party***") as promptly as practicable. If the Parties determine that a third party may be responsible for such Claim, such as a Vendor or insurance company, the Parties will work in good faith to seek indemnification from such third Party; provided the same will not relieve the Indemnifying Party from obligations under this Agreement to the extent such third party does not assume indemnification obligations for the Claim. If a third party does not assume the indemnification obligations, and the Indemnifying Party acknowledges that the terms of this Agreement apply with respect to such claim, then the Indemnifying Party shall be entitled, if it so elects, in a notice promptly delivered to the Indemnified Party, but in no event less than ten (10) days prior to the date on which a response to such claim is due, to immediately take control of the defense and investigation of such claim and to employ and engage attorneys reasonably acceptable to the Indemnified Party to handle and defend the same, at the Indemnifying Party's sole cost and expense. No settlement of a claim that involves a remedy other than the payment of money by the Indemnifying Party shall be entered into without the consent of the Indemnified Party, which consent shall not be unreasonably withheld. The Indemnified Party shall reasonably cooperate, at the cost of the Indemnifying Party, in all reasonable respects with the Indemnifying Party and its attorneys in the investigation, trial and defense of such claim and any appeal arising therefrom; provided, however, that the Indemnified Party may, at its own cost and expense (except as otherwise would be the responsibility of the Indemnifying Party hereunder), participate, through its attorneys or otherwise, in such investigation, trial and defense of such claim and any appeal arising therefrom. If the Indemnifying Party does not assume control over the defense of a claim subject to such defense as provided in this Section 12.3, the Indemnifying Party may participate in such defense, at its sole cost and expense, and the Indemnified Party shall have the right to defend the claim in such manner as it may deem appropriate, at the cost and expense of the Indemnifying Party.

12.4. LIMITATION OF LIABILITY. NO DAMAGES OTHER THAN THOSE SET FORTH IN SECTION 14.3 BELOW SHALL BE SOUGHT BY EITHER PARTY UNDER THIS AGREEMENT, AND NO PARTY SHALL BE LIABLE FOR ANY DAMAGES OTHER THAN THOSE SET FORTH IN SUCH SECTION 14.3, WHETHER IN AN ACTION BASED ON CONTRACT, TORT (INCLUDING NEGLIGENCE) OR ANY OTHER LEGAL THEORY, EVEN IF THE PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. THE FOREGOING SHALL NOT APPLY AND SHALL NOT BE DEEMED TO LIMIT EITHER PARTY'S OBLIGATION TO INDEMNIFY FOR THIRD PARTY CLAIMS UNDER THIS AGREEMENT OR LIABILITY FOR DAMAGES ARISING FROM A BREACH OF SECTION 13.

12.5. Insurance. At all times during the Term, the Parties shall maintain, at their expense, occurrence-based insurance coverage (the "***Insurance Coverage***") in the types and amounts as follows:

a) Workers' Compensation and Employer's Liability insurance affording compensation benefits for all of its employees in an amount sufficient to meet all statutory requirements and employer's liability insurance with limits of **[***]** for each accident or disease;

b) Commercial General Liability Insurance with a combined single limit of **[***]** per occurrence and **[***]** in the aggregate for personal injury, bodily injury (including wrongful death), and property damage liability inclusive of coverage for all premises and operations, broad form property damage;

c) Automobile Liability Insurance with a combined single limit of **[***]** per occurrence for injuries, including accidental death and property damage;

d) Products Liability Insurance with limits not less than **[***]** per occurrence;

e) Umbrella or Excess Liability Insurance with limits not less than **[***]** per occurrence that provides additional limits for employer's liability, commercial general liability, automobile liability and products liability insurance;

f) Property insurance and business interruption insurance with commercially reasonable limits.

g) The Insurance Coverage will be from an insurance company classified by A M Best as a Class IV or larger with a Financial Strength Rating of at least A, A-. None of the Insurance Coverage amounts will be construed as a limitation on either Party's potential liability. Within 30 days from the Effective Date each Party will provide the other Party with certificates of insurance evidencing all of the referenced insurance policies, which will be renewed annually or as policy renewals occur, and may reasonably request updated certificates from each other from time to time during the Term. Except for Workers' Compensation and Employers Liability, the required insurance policies will name the other Party, together with their respective subsidiaries and affiliates, as additional insureds.

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

12.7. Third Party Certifications. In connection with any organic Products or any certified Products of any kind (e.g., "Non GMO," Kosher, "All Natural," "not tested on animals," "cruelty free," "no animal byproducts," "biodegradable," "carbon neutral" or any other "free from" claim or certification, etc.), KeHE shall request and maintain any such records from the Vendor, as necessary. KeHE shall provide all documentation relating to the foregoing to SFM at SFM's request.

SECTION 13. – CONFIDENTIALITY

13.1. Confidentiality. In the process of making or performing under this Agreement, both Parties may have acquired, accessed or developed Confidential Information of the other Party. During the Term of this Agreement and thereafter, the Parties shall keep the Confidential Information strictly confidential and shall not disclose the same to any third party, other than the Parties auditors, attorneys or accountants, without prior written consent of the other Party, except as may be required by law, rule, regulation, governing authority or agency, in which event the disclosing Party shall promptly notify the other Party of such requirement and provide a copy of the proposed disclosure. The receiving Party shall only use the disclosing Party's Confidential Information for the purpose of performing its obligations or exercising its rights under this Agreement. The receiving Party shall be given an adequate opportunity to review and comment upon the same before disclosure is made. The Parties acknowledge that the pricing and financial terms of this Agreement, including, without limitation, those contained in the Exhibits, are highly confidential and agree to request and use their best efforts to obtain and maintain, to the extent permitted by applicable law, confidential treatment of all such terms of the Agreement, including, without limitation, by means of redacting such information from any intended disclosure. In connection therewith, the disclosing Party shall provide to the other Party copies of all correspondence, pleadings, notices, filings, and other information which pertain to obtaining and maintaining the confidential treatment of such information and shall keep the other Party advised of the status of such measures.

13.2. SFM Data. As between the Parties, all SFM Data is, or shall be, and shall remain the property of SFM and shall be deemed SFM's Confidential Information. Without SFM's approval (in its sole discretion), the SFM Data shall not be (a) used by KeHE other than as necessary for KeHE's performance under this Agreement and solely in connection with providing the Services and the performance of KeHE's obligations under this Agreement or (b) disclosed, sold, assigned, leased or otherwise provided to third parties by KeHE. Notwithstanding the foregoing, SFM Data may be shared by KeHE (i) with Vendors and their brokers, but only for such Vendor's specific products, or (ii) in an aggregated format with other KeHE sales data and disclosed to third parties for purposes of analysis and with sufficient precautions so as not to identify SFM Data.

13.3. KeHE Data. Without KeHE's approval (in its sole discretion), the KeHE Data shall not be (a) used by SFM other than as necessary for SFM's performance under this Agreement and solely in connection with providing the performance of SFM's obligations under this Agreement or (b) disclosed, sold, assigned, leased or otherwise provided to third parties by SFM.

SECTION 14. – ASSIGNMENT [***]

14.1. Prohibition of Assignments. Except as provided in Section 14.2, neither Party may assign this Agreement, except with the prior written consent of the other Party, which consent shall not be unreasonably withheld.

14.2. Permissible Assignments.

a) **[***]** Either Party may assign this Agreement without the prior consent of the other Party in connection with **[***]**.

b) **[***]**. Notwithstanding the foregoing, **[***]** without the consent of the non-assigning Party, which consent may be withheld in the non-assigning Party's sole discretion.

14.3. **[***]**

14.4. Divestiture of Stores. In the event of a divestiture of SFM Stores by SFM to a third party that does not constitute **[***]** as provided above, that third party acquiring such stores will not be considered an assignee of the Agreement and will not be subject to or benefit from this Agreement. SFM shall not disclose any of the terms set forth herein to any third-party assignee or entity to whom it divests any SFM Stores. The divestiture of stores by SFM that materially changes the volume of purchases by SFM will require the Parties to adjust the various components of the agreement to account for such material change in volume.

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

SECTION 15. – MISCELLANEOUS

15.1. Binding Effect. This Agreement, including its exhibits, supersedes all prior agreements between the Parties and constitutes the only agreement between the Parties, either oral or in writing, relating to the subject matter hereof, i.e., the supply/distribution of the Products. For the avoidance of doubt, this Agreement shall be separate and distinct from the Deli Agreement, which will continue in full force and effect and the terms unaffected by this Agreement. Upon the Effective Date the NB Agreement will terminate and neither Party shall have any further rights or obligations under the NB Agreement except with respect to Products sold prior to Effective Date.

15.2. Force Majeure. In the event of a Force Majeure, the time for performance of the obligation affected by the event of Force Majeure shall be extended by the period of Force Majeure. In the event of a Force Majeure, the Party so affected shall give prompt written notice to the other Party of the cause and shall take whatever reasonable steps are necessary to relieve the effect of such cause as rapidly as possible. The provisions of this Section 15.2 shall not apply to the financial obligations of either Party to this Agreement that are unaffected by Force Majeure. For sake of clarity, an event caused by the gross negligence or willful misconduct of either Party shall not be considered Force Majeure. The occurrence of a Force Majeure event does not excuse, limit or otherwise affect KeHE's obligation to implement the DRPs/BCPs set forth in **Exhibit H** hereto.

15.3. Governing Law and Forum. The relationship of the Parties hereto and all claims arising out of or related to that relationship, including, but not limited to, the construction and interpretation of any written agreements, including this Agreement, shall be governed by the substantive laws of the State of Delaware (without regard to conflicts of law principles). The Parties agree and consent to the jurisdiction of the state and federal courts located in New Castle County, Delaware, and acknowledge that such courts are proper and convenient forums for the resolution of any actions between the Parties with respect to the subject matter of this Agreement, and agree that, in such case, these courts shall be the sole and exclusive forums for the resolution of any actions between the Parties with respect to the subject matter hereof. The Parties hereby waive any right to a jury trial under any applicable law. The prevailing Party in any action to enforce this Agreement shall be entitled to recover all related costs of the suit, including reasonable attorneys' fees and court costs.

15.4. Amendments. This Agreement may not be amended or modified except by a writing signed by an authorized officer of each Party specifically referencing this Agreement and the intent to amend or modify.

15.5. Entire Agreement; Survival. All exhibits and schedules, and the recitals on page one (1) to this Agreement are incorporated by reference and are an integral part thereof. This Agreement (and any documents referred to herein) represents the entire agreement and understanding of the Parties with respect to the matters set forth herein, and there are no representations, warranties or conditions or agreements (other than implementing invoices, purchase orders and the like necessary to implement this Agreement) not contained herein that constitute any part hereof or that are being relied upon by any Party hereunder.

15.6. Severability. If any provision of this Agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the same shall not affect the other terms or provisions hereof or the whole of this Agreement, but such term or provision shall be deemed modified to the extent necessary, in the court's opinion, to render such term or provision enforceable, and the rights and obligations of the Parties shall be construed and enforced accordingly, preserving to the fullest permissible extent the intent and agreements of the Parties set forth in this Agreement.

15.7. Notices. Any notice required or permitted hereunder shall be given (i) via electronic mail (e-mail) with confirmation of receipt by recipient, (ii) personal delivery, (iii) by prepaid certified mail, return receipt requested, or (iv) nationally recognized overnight courier service, return receipt requested ("***Notices***"). Notices shall be addressed to the Parties at the addresses set forth below or to such other address and e-mail addresses as shall have been so notified to the other Party in accordance with this section. Notices to KeHE shall be addressed to: Chief Operations Officer, KeHE Distributors, LLC, 1245 E. Diehl Road, Suite 200, Naperville, IL 60563, with a copy not constituting notice to KeHE's Legal Department at the same address. Notices to SFM shall be addressed to: Chief Operational Officer, Sprouts Farmers Market, 5455 E High St., Suite 111, Phoenix, AZ 85054, with a copy not constituting notice to SFM's Legal Department at same address. Notwithstanding the foregoing, a Notice under Section 10 may only be delivered as set forth in subsections (ii), (iii) or (iv) above (i.e., may not be delivered via e-mail).

15.8. Waiver. Either Party's failure to insist, in one (1) or more instances, upon the performance of any term or terms of this Agreement shall not be construed as a waiver or relinquishment of such Party's right to such performance or other future performance of such term or terms, and the other Party's obligations with respect thereto shall continue in full force. Either Party's consent to or approval of any act by the other Party requiring such Party's consent or approval shall not be deemed to render unnecessary the obtaining of such consent or approval of any subsequent act.

15.9. No Agency. KeHE shall be an independent contractor hereunder, and this Agreement shall not be construed to create any other relationship between the Parties, as principal and agent, joint ventures or otherwise.

15.10. Mediation. Prior to initiating any litigation arising out of the terms of this Agreement, the Parties agree to attempt to resolve any disputes between them through mediation, which will be conducted by a mutually agreeable neutral mediator and held in a mutually agreeable neutral location. The cost of the mediation shall be borne equally by the Parties and each Party shall bear its own legal expenses and fees related to the mediation. The initiation of the dispute resolution process as described in this Section 15.10 shall not prevent a Party from exercising any of its other rights or remedies hereunder including the right to terminate this Agreement or seek injunctive relief prior to engaging in mediation in case of an emergency to preserve the status-quo.

15.11. Negotiation of Agreement. Each Party and its counsel have cooperated in the drafting and preparation of this Agreement and the documents referred to herein, and any drafts relating thereto shall be deemed the work product of the Parties and may not be construed against any Party by reason of its preparation. Any rule of law or any legal decision that would require interpretation of any ambiguities in this Agreement against the Party that drafted it shall not be applied and is hereby expressly waived.

15.12. Publicity. Neither Party shall use, in advertising or publicity or in any way related to this Agreement, the name of the other Party or any of their respective directors, officers, managers, employees, consultants or agents or any trade name, trademark, service mark, logo or symbol of the other Party, unless otherwise agreed to by such Party in advance. No press release, publicity or other form of public written disclosure related to this Agreement shall be permitted by either Party to be published or otherwise disclosed unless the other Party has indicated its consent to the form of release in writing, except for any disclosure as is deemed necessary, in the reasonable judgment of the responsible Party, to comply with national, federal or state laws or regulations with respect to regulatory reporting or disclosure obligations, including without limitation, under securities laws, subject to the Parties' confidentiality obligations under Section 13.

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

15.13. **[***]**

15.14. Remedies Cumulative. No right or remedy in this Agreement conferred upon or reserved to a Party to this Agreement is intended to be exclusive of any other right or remedy. Remedies provided for in this Agreement shall be cumulative and in addition to, and not in lieu of, any other remedies available to either Party at law, in equity or otherwise.

15.15. Counterparts. This Agreement may be executed in any number of counterparts and/or by facsimile or other electronic means agreed by the Parties, each of which shall be deemed an original, but all of which taken together shall constitute one single agreement between the Parties, and shall become effective when one or more such counterparts have been signed by each of the Parties and delivered (including by telecopy) to the other Party.

[*Signature Page to Follow*]

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IN WITNESS WHEREOF, the Parties have caused this Agreement to be duly executed by their respective authorized representatives as of the date below.

SFM, LLC dba Sprouts Farmers Market	KeHE Distributors, LLC
/s/ Amin Maredia	/s/ Brandon Barnholt
Signature	Signature
Amin Maredia	Brandon Barnholt
Print Name	Print Name
Chief Executive Officer	Chief Executive Officer
Title	Title
July 18, 2018	July 18, 2018
Date	Date

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

Schedule 1

Definitions

[***]

[***]

"***Agreement***" shall have the meaning set forth in the preamble.

"***Aging Report***" shall mean the aging transactions report that KeHE shall provide SFM every Fiscal Period showing the **[***]**.

"***Annual Review Meeting***" shall have the meaning set forth **Exhibit B** hereto.

"***APL***" or "***Authorized Products List***" shall mean list of Products carried by KeHE as reasonably requested by SFM from time to time, that are available for purchase by all or a portion of SFM Stores. KeHE shall not be required to carry any Products that **[***]**.

"***Assumptions***" shall have the meaning set forth in Section 3.4.

"***Audit Error Percentage***" shall have the meaning set forth in **Exhibit A**.

"***Audit Errors***" shall have the meaning set forth in **Exhibit A**.

"***Audit Sample***" shall have the meaning set forth in **Exhibit A**.

"***Branded Products***" shall mean all Products sold by Vendors that are not Private Label Products or KeHE-labeled Products.

"***Catch Weight Products***" shall mean Products that are invoiced based on weight (such as pounds) rather than dollars per case.

"***Cause***" shall have the meaning set forth in Section 10.1.

[***]

"***Claims***" shall have the meaning set forth in Section 12.3(a).

"***Code Life***" shall have the meaning set forth in **Exhibit G**.

[***]

"***Confidential Information***" shall mean confidential information relating to a Party's businesses that includes, but is not limited to, quality standards, business methods, sales data and trends, intellectual

property, purchasing history, pricing, marketing and pricing strategies, technical data, general or specific customer information, and financial information. Confidential Information shall include the terms and conditions of this Agreement, and information exchanged during the course of the Agreement, as provided herein, and communications between the Parties related to the Agreement or operations.

[***]

[***]

"***Cross Dock***" shall have the meaning set forth in Section 2.2(b).

[***]

"***DC***" in the singular and "**DCs**" in the plural, shall mean KeHE Distribution Centers set forth in **Exhibit F**.

[***]

"***Deli Agreement***" shall have the meaning set forth in the Recitals.

"***Delivery Uncontrollable Factors***" shall mean factors that are reasonably demonstrated to be outside of KeHE's reasonable control that affect KeHE's ability to deliver Product orders to SFM Stores during the Delivery Windows.

"***Delivery Windows***" shall mean the hours within which KeHE shall make deliveries to the SFM Stores as mutually agreed upon by the Parties, as amended from time-to-time and documented by the Parties through the ordinary course of business. Delivery Windows are based on routing considerations between KeHE's DCs and the SFM Stores.

"***Discontinued Products***" shall mean Products ordered by SFM but that are in the process of being removed from the APL, or are discontinued by the Vendor, and are no longer carried by KeHE.

[***]

[***]

"***Effective Date***" shall have the meaning set forth in the preamble.

"***Error Value***" shall have the meaning set forth in **Exhibit A**.

"***Fill Rate***" shall mean KeHE's in-stock level of all SFM Products delivered under this Agreement, calculated as follows: **[***]**.

"***Fill Rate Cure Period***" shall have the meaning set forth in Section 9.1(c).

"***Fill Rate Deficiency Notice***" shall have the meaning set forth in Section 9.1(c).

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

"Fill Rate Uncontrollable Factors" shall mean factors that are reasonably demonstrated to be out of KeHE's control that may affect KeHE's ability to fulfill Product orders to SFM Stores and that may affect the Fill Rate. These may include, but are not limited to, **[***]**.

"***Fiscal Period***" shall mean the period of time of four (4) or five (5) weeks, as applicable, within SFM's Fiscal Year. There are 12 Fiscal Periods in a Fiscal Year.

"***Fiscal Quarter***" shall mean the period of time composed of 13 or 14 weeks, as determined by the Fiscal Year. There are four (4) Fiscal Quarters in a Fiscal Year.

"***Fiscal Year***" shall mean the period of time composed of 52 or 53 weeks, as determined by SFM's financial statements.

"***Force Majeure***" shall mean events beyond the reasonable control of a Party (and not through the fault or negligence of such Party) that are not reasonably foreseeable with the exercise of reasonable care, nor avoidable through the payment of nonmaterial additional sums, such as earthquakes, elements of nature or acts of God or events of a similar nature, that make timely performance of an obligation not possible and which could not have been prevented through the implementation of commercially reasonable precautions.

[***]

[***]

[***]

[***]

[***]

[***]

[***]

[***]

[***]

[***]

[***]

"***Indemnified Party***" shall have the meaning set forth in Section 12.3(c).

"***Indemnifying Party***" shall have the meaning set forth in Section 12.3(c).

"***Insurance Coverage***" shall have the meaning set forth in Section 12.5.

"***KeHE***" shall have the meaning set forth in the preamble.

[***]

"***KeHE Data***" shall mean all data and information regarding KeHE and KeHE's sales of Products to SFM or any other customers, KeHE's methodology or pricing related to the sale of Products and Services, and any financial information related to KeHE, (a) submitted to SFM by or on behalf of KeHE, (b) obtained, developed or produced by or on behalf of SFM or SFM personnel in connection with this Agreement, or (b) to which SFM or SFM personnel have access in connection with the sale of Products and Services.

"***KeHE Indemnitees***" shall have the meaning set forth in Section 12.3(b).

"***KeHE Private Label Claim***" shall have the meaning set forth in Section 12.3(a).

"***KeHE's Hold Harmless Agreement***" shall have the meaning set forth in **Exhibit J**.

"***Mark-Up***" shall have the meaning set forth in Section 3.1.

[***]

[***]

"***Market Price***" shall mean the price of Products at which a buyer and seller agree to trade in an open market at a particular time.

"***NB Agreement***" shall have the meaning set forth in the Recitals.

"***Net Purchases***" shall have the meaning set forth in **Exhibit A**.

"***New DC***" shall mean a DC opened after the Effective Date.

"***New Products***" shall mean Products ordered by SFM but that have not yet been received into the KeHE DC that fulfills such order.

"***Non-Conforming Products***" shall have the meaning set forth in **Exhibit A**.

"***Notices***" shall have the meaning set forth in Section 15.7.

"***On-Time Delivery"*** shall mean delivery of Products by KeHE to SFM Stores that occur within the agreed upon Delivery Windows.

[***]

"***OTP Cure Period***" shall have the meaning set forth in Section 9.2(c).

"***OTP Deficiency Notice***" shall have the meaning set forth in Section 9.2(c).

"***OTP Rate***" shall have the meaning set forth in Section 9.2.

"***Order***" shall mean an order for Products placed by the SFM Stores to KeHE.

"***Order Size***" shall mean the total Purchase value per Order.

[***]

"***Party***" or "***Parties***" shall have the meaning set forth in the Preamble.

[***]

[***]

[***]

[***]

"***Primary Supplier***" shall mean that all SFM Stores will purchase **[***]**

"***Private Label Products***" shall mean Products that are labeled with an SFM trademark or whose labels are controlled by SFM and sold exclusively by SFM. Except as otherwise set forth in the Agreement, Products shall include Private Label Products.

"Products" shall mean all products purchased by SFM from third-party distributors or that are self-distributed by SFM for the following categories: grocery, frozen, dairy, vitamins and supplements, and health & beauty (i.e., the categories covered by the NB Agreement), excluding any products purchased by SFM from a manufacturer for direct store delivery.

"***Projected Annual Purchases***" shall have the meaning set forth in Section 1.2(f).

"Purchase" or ***"Purchases"*** shall mean the dollar value of purchases of Product made by SFM under this Agreement **[***]**

"***Quarterly Reconciliation***" shall have the meaning set forth in Section 7.2(b).

[***]

[***]

[***]

"***Services***" shall mean all of the services provided by KeHE to SFM set forth in the Agreement, including but not limited to those set forth in Sections 2 and 4.2 of the Agreement.

"***SFM***" shall have the meaning set forth in the preamble.

"***SFM Data***" shall mean all data and information regarding SFM and the SFM Stores, including data relating to SFM's purchases of Products, (a) submitted to KeHE by or on behalf of SFM or any SFM Store, (b) obtained, developed or produced by or on behalf of KeHE or KeHE personnel in connection with this Agreement, or (c) to which KeHE or KeHE personnel have access in connection with the provision of the Services.

"***SFM Indemnitees***" shall have the meaning set forth in Section 12.3(a).

"***SFM Pick-Up***" shall have the meaning set forth in Section 2.2(b).

[***]

"***SFM Stores***" shall have the meaning set forth in the Recitals.

[***]

[***]

[***]

"***Split Orders***" shall mean the orders placed by SFM Stores to KeHE which KeHE may split into multiple deliveries, as determined by KeHE through ordinary course of business when order volume or other factors may require it.

"***Standards***" shall have the meaning set forth in **Exhibit H**.

[***]

"***Term***" shall have the meaning set forth in Section 1.1.

[***]

[***]

[***]

"***Transition Period***" shall have the meaning set forth in Section 10.3.

[***]

[***]

"***Vendor***" or "***Vendors***" shall mean sellers of Products to KeHE which may include manufacturers, brokers, sellers, co-packers, other KeHE divisions or affiliates, and any other sources from whom KeHE purchases Products.

[***]

[***]

[***]

[***]

[***]

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

2018 Distribution Agreement – List of Exhibits

EXHIBIT A – **[***]**
EXHIBIT B – Transportation Costs
EXHIBIT C – Assumptions
EXHIBIT D – **[***]**
EXHIBIT E – Reporting Schedule
EXHIBIT F – KeHE Distribution Centers
EXHIBIT G – Code Life Standards
EXHIBIT H – Service Level Agreement
EXHIBIT I – Representations, Warranties and Covenants
EXHIBIT J – Vendor Standards

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EXHIBIT A – [***]

This **[***]** sets forth the policy addressing Products that are damaged at the time of delivery, short-shipped Products and mis-picked Products ("***Non-Conforming Products***"). **[***]**

Audit and Audit Errors: An audit shall be conducted of a sample size of Net Purchases made by Product department (i.e., Dry, Refrigerated, Frozen, Each Pick etc.), **[***]** (the "***Audit Sample***"). Such audits occur as agreed upon by the Parties at the KeHE DC and SFM Stores. The errors identified in the sample size ("***Audit Errors***") may be expressed as a monetary value ("***Error Value***") or expressed as a percentage of the Audit Sample ("***Audit Error Percentage***"), subject to adjustment as set forth below. An example of this is set forth in Example 1 below.

EXAMPLE 1

AUDIT SUMMARY				
KEHE DC	DEPT	ORDER SIZE AUDITED	TTL AUDIT ERRORS	AUDIT ERROR %
CHINO	DRY	$20,000	$50.00	0.25%
CHINO	REFRIG	$15,000	$50.00	0.33%
CHINO	FROZEN	$10,000	$50.00	0.50%
CHINO	EACH	$5,000	$50.00	1.00%
CHINO	TOTAL	$50,000	$200.00	0.40%

Audit Errors include the following:

- *Mispicks on APL* – an item is received on the order that was not ordered, is not on the invoice and is part of the APL.
- *Mispicks not on APL* – an item is received on the order that was not ordered, is not on the invoice and is not part of the APL.
- *Short on APL* - an item that was ordered is on the invoice but missing from the order and is part of the APL.
- *Short not on APL* - an item that was ordered is on the invoice but missing from the order and is not part of the APL.
- *Damage on APL* - an item is received on the order that is damaged either partially or in whole, is on the invoice and is part of the APL.
- *Damage not on APL* - an item is received on the order that is damaged either partially or in whole, is on the invoice but is not part of the APL.
- *Overages on APL* - a larger quantity of an item is received than was on the order and the invoice and is part of the APL.
- *Overages not on APL* - a larger quantity of an item is received than was on the order and the invoice and is not part of the APL.

The Error Value, and thus the resulting Audit Error Percentage, shall be adjusted depending on the type of Audit Error on a weighted basis as follows **[***]**

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

An example of adjustment to the Error Value, corresponding Audit Error Percentage, and the resulting **[***]** is set forth below in Example 2.

EXAMPLE 2
[***]

Note: Customer returns will be charged back to Vendors, subject to Section 2.4(c) of the Agreement.

The Parties agree to revisit **[***]**, provided it is mutually and equally benefiting to both Parties from an overall operational and financial standpoint, and geared towards improving the accuracy and quality of deliveries (i.e., reduce number of Non-Conforming Products).

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

EXHIBIT B – Transportation Costs

On or before sixty days from the Effective Date the Parties will conduct and validate a transportation simulation **[***]**

[***]

[***]

11. Independent Review: All references to Independent Review in this Exhibit shall be based on the following parameters:

    a. Independent reviews shall be conducted by a nationally recognized public accounting firm with appropriate expertise in transportation matters; the Parties will work together in good faith to agree upon such accounting firm.

    b. A Party submitting a dispute for independent review shall initially bear all costs and expenses associated with such review; **[***]**.

    c. The findings of the independent reviewer shall be conclusive and binding on the Parties.

    d. A Party may submit a dispute for independent review no more than once per year.

    e. Independent review will be limited **[***]**.

12. Fuel Surcharge: For each delivery of Products to SFM Stores, KeHE may (i) add a fuel surcharge if KeHE's cost of diesel fuel per gallon is equal to or greater than **[***]**, or (ii) provide a credit to SFM if the cost of diesel fuel per gallon is equal to or less than **[***]**, using the table below.

[***]

Note: The table above was provided by KeHE to estimate what the charge per fuel band would be per delivery of Product. The Parties agree to review the per delivery charges, i.e., fuel surcharges, set forth in the table above **[***]**.

The cost of diesel fuel per gallon will be calculated using the diesel fuel prices from the U.S. Energy Information Administration posted here:

https://www.eia.gov/dnav/pet/pet_pri_gnd_a_epm0_pte_dpgal_w.htm.

The cost of diesel fuel per gallon (and corresponding fuel surcharge) will be determined for each individual SFM Store based on the SFM Store location using **[***]**.

[***]

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

EXHIBIT C – Business Model Assumptions

- Projected Annual Purchase expectation described in Section 1.2
- Average annual volume of Orders per SFM Store **[***]**
- Average Order value of Products per SFM Store **[***]**
- Average Order value of Products per SFM Store **[***]**
- Average number of Orders per SFM Store per week = **[***]**

[***]

a. Dry – **[***]**
b. Refrigerated – **[***]**
c. Frozen – **[***]**

[***]

a. Dry – Approx. [***]
b. Refrigerated – Approx. [***]
c. Frozen = Approx. **[***]**

[***]

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

EXHIBIT D – [***]

As provided in Section 7 of the Agreement, the Parties have identified certain initiatives to **[***]**, summarized in the table below and further explained in this **Exhibit D**.

[***]

15.16. **[***]**. During the Term, SFM will use commercially reasonable efforts to help KeHE improve **[***]**.

a) **[***]** *Initiatives*. SFM will **[***]**. Any variances to these will be mutually agreed upon on a good faith exception basis (ex., short-dated, dairy vendors). SFM also agrees to support KeHE's efforts to **[***]**. KeHE will apply a **[***]**. KeHE will **[***]**. Furthermore, the Parties agree to work in good faith to **[***]**.

b) *Baseline*. As of the Effective Date, **[***]** will be assumed to be as follows **[***]**. The Parties agree that **[***]**

c) *Variance to* **[***]**

i. **[***]**. In years 1 and 2 of the Term, **[***]**.

In year 3 and for the remainder of the Term, **[***]**.

ii. **[***]**. If however, starting in year 3 of the Agreement: **[***]**

15.17. **[***]**. The Parties agree to jointly use commercially reasonable efforts to improve **[***]**.

15.18. **[***]**. As of the Effective Date, KeHE is in the process of **[***]**.

15.19. Private Label Supplier Initiatives. The Parties will work together to implement the following initiatives related to Vendors of SFM's Private Label Product:

a) *Private Label* **[***]**. All Private Label Product Vendors **[***]**.

b) **[***]**

c) **[***]**. Within the first year of the Term, SFM will use best efforts to require **[***]**

d) **[***]**. In consideration of SFM implementing the **[***]**.

15.20. **[***]**.

[***]

[***]

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

EXHIBIT E – Reporting Schedule

[***]

Note: Any delays or inaccuracies in reporting may result in **[***]**.

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

EXHIBIT F – KeHE Distribution Centers

Chino, California
16081 Fern Avenue
Chino, CA 91710

Flower Mound, Texas
101 Enterprise Drive
Flower Mound, TX 75028

Stockton, California
4650 Newcastle Road
Stockton, CA 95215

Aurora, Colorado
2200 N. Himalaya Rd.
Aurora, CO 80011

Douglasville, Georgia
1851 Riverside Avenue
Douglasville, GA 30135

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

EXHIBIT G – Code Life Standards

KeHE agrees that, as to every Product provided to SFM pursuant to this Agreement (including Private Label Product), not less than the following specified periods of time shall be remaining between the date of the delivery of the Product to the SFM Store and the Code Date specified on the Product (the "**Code Life**"):

[***]

Specific Vendor shelf life guarantees will dictate the pull date established. The category examples provided above are meant as a guideline to establish expectations, but ultimately, the guaranteed shelf life provided from the Vendor will dictate the minimum provided to SFM.

The Code Life may be modified based on logistics and manufacturers limitations. All exceptions must be specific in writing from the manufacturer and approved by SFM and KeHE.

SFM may reject products if the products delivered are not within the Code Life (i.e., short-coded product). SFM shall report any short-coded product pursuant to Exhibit A of the Agreement.

[***]

Within six (6) months of the Effective Date, the Parties will review the Code Dates above in good faith and determine any necessary changes that may be applicable, taking into account whether Products are arriving at the SFM Stores within, or close to, the Code Dates.

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

EXHIBIT H – Service Level Agreement

The following agreed upon service levels shall be in addition to any other service levels set forth in the Agreement and its corresponding exhibits:

Quality Control. All Products shall be handled in accordance with the Vendor's specifications or instructions, if any, and following good distribution practices (the "***Standards***") while such Products are in the possession of KeHE. Upon receipt by KeHE, KeHE shall inspect Product dates and the quality and integrity of such Products for conformance to the Standards. If any inspection performed hereunder indicates a failure to conform to the Vendor's specifications or any other quality requirements, KeHE shall not deliver the Products from such shipments without the express written consent of SFM, which consent may be granted or withheld in SFM's sole discretion.

Acceptance. **[***]**, all deliveries of Products by KeHE are subject to SFM's acceptance of such Products per SFM's receiving policy. SFM may **[***]**.

Recalls. KeHE agrees that it has and will maintain a reliable recall system and policies in place including appropriate tracking, coding, and accounting systems for all Products. KeHE will promptly pass along the existence of formal communications from Vendors regarding product recalls. The Parties will cooperate with one another in documenting the quantity of product destroyed, withdrawn or otherwise removed as a result of a recall. **[***]**. In the event that such recall results from the storage or handling of the recalled Product by KeHE or KeHE Agents, KeHE shall be responsible for reasonable documented out-of-pocket expenses of such recall. KeHE shall promptly respond to SFM inquiries and communications regarding Product recalls.

Merchandising Support. KeHE will provide SFM with **[***]** to provide merchandising support. For existing SFM Stores that undergo remodels, refreshes, and sales initiatives (but not for resets), KeHE will provide **[***]**.

Disaster Recovery and Business Continuity. **[***]**, KeHE will have a business continuity plan ("BCP") and disaster recovery plan ("DRP") for each DC in place to ensure SFM an effective and efficient continuity of Product supply. KeHE shall provide a copy of its BCPs and DRPs to SFM as reasonably requested from time to time. KeHE shall notify SFM of any material change or modification in the BCP and DRP; and (b) no more than once per year and at the request of SFM upon not less than 30 days' advance notice, participate in a walk-through of KeHE's BCPs and DRPs with SFM. KeHE shall test, at KeHE's expense, each BCP and DRP no less than once per year and promptly upon completing each test provide a copy of the test results to SFM. If SFM, acting reasonably, considers there to be a deficiency in the test results, KeHE agrees to work with SFM to fix the deficiency. The BCP and DRP will include, without limitation, the actions that KeHE will take in the event the distribution environment and/or KeHE's DCs are subject to a Force Majeure event, its computer network experiences a network disruption or security breach or other unforeseen circumstance.

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

EXHIBIT I – Representations, Warranties and Covenants

KeHE and SFM make the following representations and warranties to and for the benefit of the other Party, its successors and permitted assigns:

(A) Organization. KeHE and SFM are both limited liability companies duly organized, validly existing and in good standing under the laws of the State of Delaware and have full power and authority to own, lease and operate their business. Both Parties are duly licensed and qualified to do business and are in good standing in the states where their business requires it to be so licensed and qualified.

(B) Authorization. KeHE and SFM have all necessary power and authority and have taken all action necessary to enter into this Agreement, to consummate the transactions contemplated hereby and to perform their obligations hereunder.

(C) Compliance with Law. Neither KeHE or SFM have received any written notification alleging any existing material violation of, and to the best of their knowledge, they are not in material violation of, any applicable law, statute, rule, regulation, ordinance, code, order, license, permit or authorization.

(D) Litigation and Proceedings. There are no material actions, suits or proceedings pending or, to the best the Parties' knowledge, threatened against either, at law or in equity or before or by any governmental authority or before any arbitrator of any kind, which would have a material adverse effect on KeHE's ability to perform its obligations hereunder.

KeHE agrees as follows:

(E) KeHE has **[***]** adequate processes and systems in place, and that it will fully comply with all federal, state and local regulations relating to handling and labeling of organic Products, including, but not limited to, the National Organic Standards as promulgated by the USDA and as such applies to KeHE as a handler or processor of organic foods. KeHE acknowledges that SFM has placed substantial reliance on KeHE to handle various foods for human consumption so as to not invalidate any "organic" designation of such foods.

(F) KeHE has industry standard information technology security safeguards in place to protect the confidentiality of SFM Data as contained in KeHE's computer systems. KeHE has a disaster recovery program in place to ensure that, in the event of a catastrophic destruction of any portion of KeHE's computer systems, wherever located, KeHE has standard systems in place to recover all necessary data to continue to perform its obligations hereunder.

(G) Upon delivery of Products to the SFM Stores, **[***]**. Upon SFM's purchase of Products, the Products will be free of any liens, claims or other encumbrances.

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

EXHIBIT J – Vendor Standards

As of the Effective Date, KeHE shall use best efforts to require each new Vendor to execute KeHE's standard Hold Harmless Agreement and Guarantee/Warranty of Product ("***KeHE's Hold Harmless Agreement***"), a copy of which is included below. To the extent any Vendor does not sign KeHE's Hold Harmless Agreement after using best efforts, the Parties will work together in good faith to obtain Vendor's signature and will handle exceptions on a case by case basis through ordinary course of business. Additionally, the Parties shall work in good faith on a reasonable timeline to obtain KeHE's Hold Harmless Agreement from existing Vendors and procure certifications from Vendors regarding the following:

1) All Products are manufactured, packaged, labeled, packed, shipped and invoiced in compliance with the applicable requirements of federal, state and local laws, regulations, ordinances and administrative orders and rules of the United States and all other countries in which the Product is manufactured and that all required labeling is affixed to Products and passed on to KeHE or its customers;

2) All Products are (a) not adulterated or misbranded within the meaning of the Federal Food, Drug and Cosmetic Act, as amended, and regulations adopted thereunder (the "FD&C Act"); (b) not articles that are prohibited, under the FD&C Act or any successor thereto, from being introduced into interstate commerce; (c) not prohibited under any public health, safety or environmental laws, or any other laws regulations or ordinances of any state or other government authority which are applicable to such shipment or delivery; (d) merchantable and fit for their intended purpose, and will pass without objection in trade; and (e) compliant with all applicable provisions of the Meat Inspection Act, Poultry Product Inspection and/or Egg Product Inspection Act, including all applicable rules and regulations adopted thereunder.

3) If applicable, all advertising and promotional materials developed or provided by Vendor for any Product will comply with all applicable requirements of federal, state and local laws, regulations, ordinances and administrative orders and rules of the United States and all other countries in which the Vendor does business, including, without limitation and if applicable, those promulgated by the U.S. Food and Drug Administration, the U.S. Department of Agriculture, the U.S. Federal Trade Commission and the Environmental Protection Agency;

4) Vendor (a) verifies its product supply chains to evaluate and address risks of human trafficking and slavery (and will disclose to KeHE whether a third party conducted the evaluation for Vendor); (b) audits its own suppliers to evaluate compliance with Vendor's company standards (and will specify to KeHE whether the audits are independent and unannounced); (c) requires its direct suppliers to certify that the products they provide to Vendor comply with the laws of the country in which the supplier does business; (d) maintains internal accountability standards for employees and contractors concerning human trafficking and slavery; (e) ensures that Vendor employees and management responsible for supply chain management are trained to identify human trafficking and slavery and how to mitigate risks within supply chains;

5) Vendor and all employees and agents involved in the manufacturing, processing or delivery of the Products will strictly adhere to all applicable federal, state and local laws, regulations and prohibitions of the United States, its territories and all countries in which the Product is produced with respect to the operation of their production facilities and their other business and labor practices, including but not limited to the California Transparency in Supply Chains Act of 2010, and comply with existing local and federal laws regarding slavery and human trafficking in the country or countries in which KeHE's business with Vendor is being conducted; and

6) All intellectual property or proprietary rights used by Vendor in connection with the Products are owned by Vendor or Vendor has been properly authorized to use such rights in connection with the Products and to sell the Products that incorporate such proprietary rights to KeHE for use or further resale.

7) Vendor manufactures or causes Product to be manufactured in facilities with a Hazards Analysis and Critical Control Points (HACCP) plan and/or carries out annual third party audits (e.g., ASI, SQF, GMP) to ensure food safety protocols are being followed, which shall be available upon request.

KeHE and SFM agree to work in good faith on a Vendor by Vendor basis and on a mutually agreed upon reasonable timeline, to require Vendors to provide the above certifications.

HOLD HARMLESS AGREEMENT
AND
GUARANTEE/WARRANTY OF PRODUCT

The undersigned person or entity ("Seller"), for value to be received from purchases by Buyer (as defined below), hereby agrees:

1. The articles contained in any shipment or delivery made by Seller, its subsidiaries or affiliates (a "Product") made to or on the order of KeHE Distributors, LLC, its subsidiaries or affiliates (collectively referred to as "Buyer") are hereby guaranteed, as of the date of such shipment or delivery: (a) to not be adulterated or misbranded within the meaning of the Federal Food, Drug and Cosmetic Act, as amended, and in effect at the time of such shipment or delivery (the "Act") or within the meaning of any applicable federal, state or municipal law, rule, regulation, or ordinance, (b) to not be an article which cannot be introduced into interstate commerce under the provisions of Act, and (c) to be in compliance with all federal, state, and local laws, rules, and regulations applicable to the Product and to the manufacture, packaging, sale, shipment, and delivery of the Product, including, without limitation, all labeling and disclosure laws and regulations, such as California's Safe Drinking Water and Toxic Enforcement Act of 1986, Health and Safety Code Section 25249.5 ("Proposition 65").

2. Seller agrees to defend, indemnify and hold harmless Buyer and its subsidiaries, affiliates, employees, officers, directors, and customers (individually, an "Indemnitee") from all actions, suits, claims and proceedings ("Claims") and any judgments, damages, fines, costs, and expenses (including reasonable attorney's fees):

   (a) Brought or commenced by federal, state, or local governmental authorities or any third party against any Indemnitee alleging that any Product sold by Seller to, or on the order of, Buyer did not meet the guarantee, or any portion thereof, set forth in Paragraph 1;

   (b) Brought or commenced by any person or entity against any Indemnitee for the recovery of damages for the injury, illness, and/or death of any person or damage to property as a result of (i) the delivery, sale, resale, labeling, use, or consumption of any Product; or (ii) the negligent acts or omissions of Seller or its employees, agents, or contractors; provided, however, that Seller's indemnification obligations hereunder shall not apply to the extent that any Claims are caused by the negligence or intentional misconduct of Buyer or its employees, agents, or contractors; or

   (c) Brought or commenced by any person or entity against any Indemnitee alleging that any Product or advertisements, labels, configuration, point of purchase displays, and other items supplied by Seller to Buyer implicate or infringe upon a copyright, slogan, trademark, trade dress, patent, right of privacy, right of publicity, name, likeness, or any other intellectual property right, including, but not limited to, rights arising under common law and statutory unfair competition laws.

Seller's indemnity obligations herein shall survive the termination of the distribution relationship between the parties.

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

3. Seller agrees to maintain in effect insurance coverage with reputable insurance companies (having at least an "A" or better Financial Strength Rating according to the latest A.M. Best Report) licensed to do business in the jurisdictions in which the Products are to be distributed under forms of policies reasonably acceptable to Buyer covering workers' compensation and employers' liability, automotive liability, commercial general liability, including product liability and excess liability, all with such limits as are sufficient in Buyer's reasonable judgment to protect Seller and Buyer from the liabilities insured against by such coverage, provided that Seller's commercial general liability insurance shall be in the amount of at least $2,000,000 per occurrence and in the aggregate for all items; provided in the event Seller sells any vitamins, minerals, herbs and nutritional supplements, such limits shall be at least $5,000,000 per occurrence. Seller shall designate Buyer as an additional insured under the commercial general liability policy and provide Buyer with certificates evidencing the above-referenced coverages, upon execution of this Agreement and prior to each renewal of such policies. Such policies shall require that all insureds be given at least thirty (30) days' written notice prior to any cancellation or material modification of such policies.

4. This Agreement is continuing and shall be in full force and effect and shall be binding upon Seller with respect to each and every Product shipped or delivered to Buyer by the Seller.

_____ Dated this _____day of_____, 20_.

Print Company Name

_____
Signature of Authorized Official of Seller

Address for Notices: _____

_____

_____

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Section 3: EX-31.1 (EX-31.1)

Exhibit 31.1

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

I, Amin N. Maredia, certify that:

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

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

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

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

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

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

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

based on such evaluation; and

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

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

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

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

Date: November 1, 2018

/s/ Amin N. Maredia

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

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Section 4: EX-31.2 (EX-31.2)

Exhibit 31.2

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

I, Bradley S. Lukow, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: November 1, 2018

/s/ Bradley S. Lukow

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

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Section 5: EX-32.1 (EX-32.1)

Exhibit 32.1

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

In connection with the quarterly report of Sprouts Farmers Market, Inc. (the "Company"), on Form 10-Q for the quarterly period ended September 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Amin N. Maredia, Chief Executive Officer of the Company, certify, based on my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: November 1, 2018

/s/ Amin N. Maredia

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

This certification accompanies the Report to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.
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Section 6: EX-32.2 (EX-32.2)

Exhibit 32.2

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

In connection with the quarterly report of Sprouts Farmers Market, Inc. (the "Company"), on Form 10-Q for the quarterly period ended September 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bradley S. Lukow, Chief Financial Officer of the Company, certify, based on my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: November 1, 2018

/s/ Bradley S. Lukow

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

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

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