

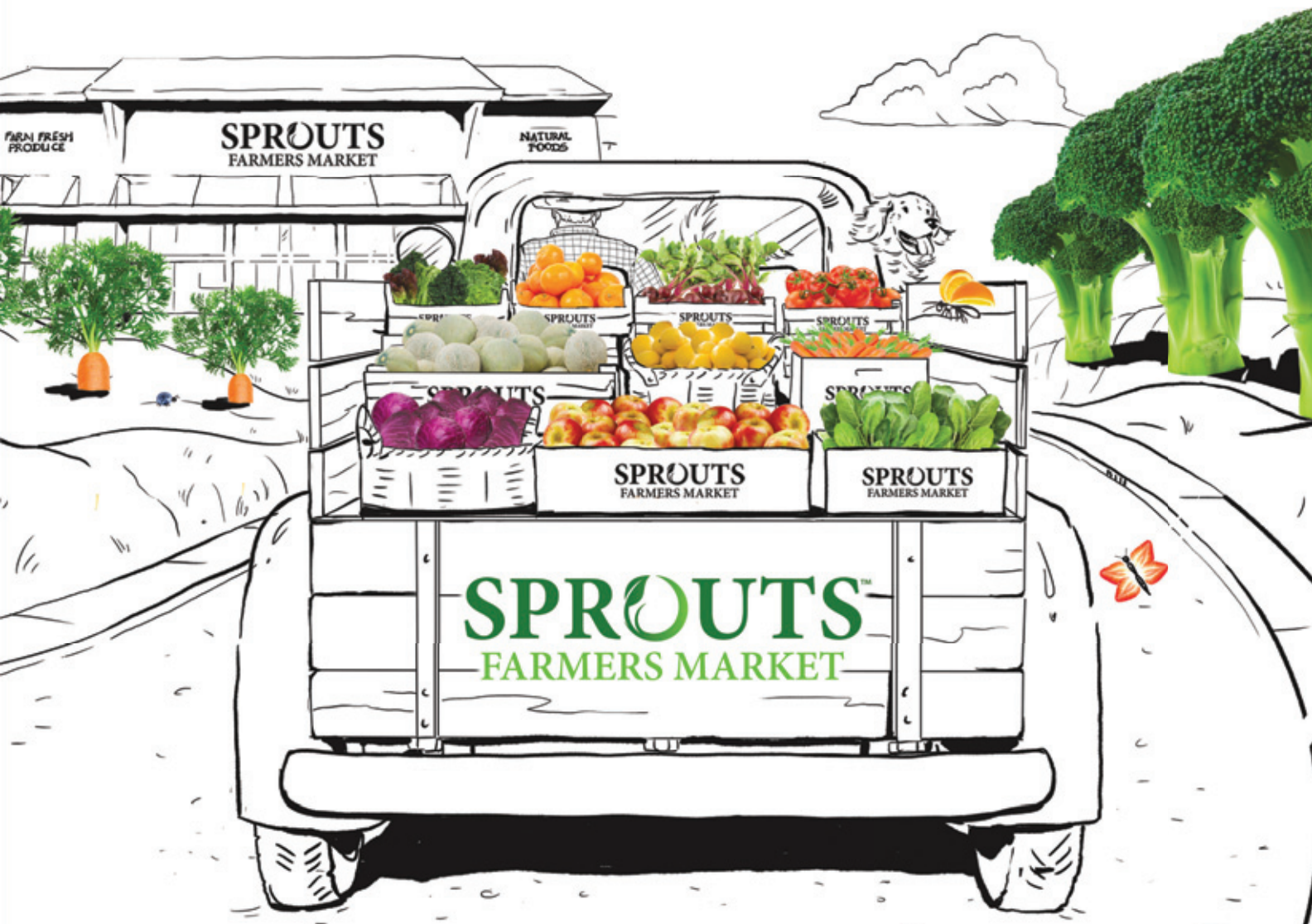


SPROUTS™

FARMERS MARKET

2020

ANNUAL REPORT





TO OUR SHAREHOLDERS,

We have a passionate and purpose-driven team here at Sprouts, and it has been an incredible privilege to lead a company rooted in improving the health of the communities it serves. Last year, our 35,000 team members achieved another year of record sales and earnings despite enormous uncertainty spurred by a global pandemic. Our success would not be possible without our team members' devotion, passion, and hard work. I am incredibly proud of how our teams came together to deliver fantastic results for our shareholders, all while improving access to healthy food across the country.

Sprouts is not a traditional grocery store; we are a unique brand offering the latest in fresh, wholesome, and innovative products. Over the last two decades, we have remained true to our farm-stand heritage by providing a differentiated grocery experience with a carefully curated assortment of healthy alternatives and good-for-you options.

COVID-19: PRIORITIZING THE SAFETY AND WELLBEING OF OUR TEAM MEMBERS AND CUSTOMERS

We're so grateful to our team members serving our communities during these times. As the global crisis unfolded, we moved quickly to safeguard our team members. We've protected their safety by investing more than \$12 million in COVID protective measures, including installing plexiglass partitions, providing PPE, increasing store security, and establishing enhanced cleanliness protocols. We recognized team member efforts through additional benefits that included paying more than \$100 million in expedited bonuses, increased paid sick time, and 100% testing cost coverage. We also took steps to protect their financial wellbeing by creating a disaster relief fund to help team members in need and provided grants totaling more than \$12 million in financial support.

DELIVERING ON OUR STRATEGY IN 2020

The world changed during the pandemic, and as we reflect on the year, the events of 2020 have only made Sprouts stronger.

We were able to accelerate our strategic initiatives more quickly than initially planned due to the pandemic. Implementing our strategy at a rapid pace fueled our remarkable results in 2020. Our top-line grew 15% to \$6.5 billion in sales, and we delivered an increase of 99% in adjusted diluted earnings per share to \$2.49, including a rapid increase in e-commerce sales, and 22 new store openings.

Early in 2020, we stopped our print ads to speed up our marketing strategy for the long run as we swiftly shifted to digital channels permanently. We've created significantly more personal digital touchpoints through our new customer targeting tools, helping us reach our target customers more effectively. And the shift from print to digital also helped us achieve a positive environmental impact through saving paper and averting 60,000 metric tons of carbon dioxide.

In August we released a new brand campaign – "Sprouts, Where Goodness Grows™", and launched our first ever TV commercials, doubling brand awareness and reaching more customers. This new approach resulted in an increase of 48% active customer emails and 200% total CRM growth, showing that we are accelerating the reach of our Sprouts brand while continuing to provide value to our customers.

We created a full omnichannel experience, providing our customers the opportunity to shop the way that works best for them, whether through in-store, home delivery, or curbside pick-up. Our quick rollout of curbside pick-up in all of our stores, combined with the release of shopping through our own website, shop.sprouts.com, resulted in e-commerce sales growing to over 9% of our total sales, up more than 290% compared to last year.

Our go-to-market strategy has changed with our thoughtful approach to better everyday pricing, purposeful promotions and getting back to our roots of a produce buying organization, which is nimble and flexible. These changes have positively changed our financials for the long-term. We have now established a solid base from which we can invest and grow, exiting 2020 ahead of our original strategic plan and in a much stronger position than we began.

Even considering these incredible results, what excites me most is what lies ahead!

WHAT YOU CAN EXPECT FROM SPROUTS IN 2021

Going forward, our continued focus on our strategy will be to win with our target customer through improved analytics, establishing ourselves as the destination for innovation and successfully operating in more locations across the country supported by more local distribution centers. As our customer database evolves, we will have a better understanding of our customers' shopping behaviors. We will continue our strategy of elevating our brand awareness and reach more of our target customer base through digital-driven communications.

Innovation drives our assortment and our differentiated products (nearly 68% of our products are attribute-driven!) set us apart from the competition. Our in-depth category work this past year anticipating trends and identifying products that are preferred by our target customer are helping to position us as a source for product and brand innovation. In 2021 we'll keep innovation top of mind as we continue our enhanced category review process to ensure we not only offer the high-quality products our customers want, but display them in the way that works best for how they shop our stores.

We'll continue to expand at a rate that remains one of the best in grocery and across retail in 2021. We plan to open approximately 20 new stores this year, a handful of which will be in our new format with a smaller footprint of 25,000 square feet or less and better returns. Beyond 2021, we are targeting annual growth of 10% or more. We'll continue highlighting our open layout and farmers' market experience with produce at the heart of the store and an innovation center to showcase our differentiated product offerings.

Lastly, we will open two new fresh distribution centers this year. This will drive us closer to our goal of having our stores within 250 miles of our DCs to create an advantaged, fast, and fresh supply chain. Regional DCs will also help us support community/neighborhood farmers and grow our local produce offerings as we expand the selection of unique regional produce our customers are looking for, while guaranteeing freshness of all products.

Looking ahead, we know that the world will look very different on the other side of this crisis, and we will remain unwavering in our team members' and customers' safety protocols. Although we are only in the early innings of our strategy, we entered 2021 on a solid foundation. I am excited about all that we are building on this great brand! The focus on health and wellness is here to stay, which bodes well for our differentiated store model that will support our future growth prospects to provide broader access to healthy living and creating value for our shareholders.

Sincerely,

Jack Sinclair,
Chief Executive Officer



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

FORM 10-K

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

For the fiscal year ended January 3, 2021

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 001-36029

SPROUTSTM
FARMERS MARKET

Sprouts Farmers Market, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

32-0331600
(I.R.S. Employer
Identification No.)

5455 East High Street, Suite 111
Phoenix, Arizona 85054

(Address of principal executive offices and zip code)

(480) 814-8016

(Registrant's telephone number, including area code)

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, \$0.001 par value	SFM	NASDAQ Global Select Market

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

None

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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, a 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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

As of June 26, 2020, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's voting common stock held by non-affiliates of the registrant was \$2,915,586,804, based on the last reported sale price of such stock as reported on The NASDAQ Global Select Market on such date.

As of February 23, 2021, there were 117,953,435 outstanding shares of the registrant's common stock, \$0.001 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its 2021 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K where indicated. Such Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended January 3, 2021.

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As used in this Annual Report on Form 10-K, unless the context otherwise requires, references to the “Company,” “Sprouts,” “we,” “us” and “our” refer to Sprouts Farmers Market, Inc., a Delaware corporation, and, where appropriate, its subsidiaries. The inclusion of our website addresses in this Annual Report on Form 10-K does not include or incorporate by reference the information on or accessible through our websites herein.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains “forward-looking statements” that involve substantial risks and uncertainties. The statements contained in this Annual Report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the “Exchange Act”), including, but not limited to, statements regarding our growth strategy, expectations, beliefs, intentions, 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 Annual Report on Form 10-K. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

PART I

Item 1. **Business**

Sprouts Farmers Market offers a unique grocery experience featuring an open layout with fresh produce at the heart of the store. Sprouts inspires wellness naturally with a carefully curated assortment of better-for-you products paired with purpose-driven people. We continue to bring the latest in wholesome, innovative products made with lifestyle-friendly ingredients such as organic, plant-based and gluten-free. Since our founding in 2002, we have grown rapidly, significantly increasing our sales, store count and profitability. Headquartered in Phoenix with 362 stores in 23 states as of January 3, 2021, we are one of the largest specialty retailers of fresh, natural and organic food, and fastest growing retailers in the United States.

Our Heritage

In 2002, we opened the first Sprouts Farmers Market store in Chandler, Arizona. From our founding in 2002 through January 3, 2021, we have grown rapidly, significantly increasing our sales, store count and profitability, including successfully rebranding to the Sprouts banner 43 Henry's Farmers Market and 39 Sunflower Farmers Market stores added in 2011 and 2012, respectively, through acquisitions. 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.

Our Growth Strategy

In 2020, we announced the initial steps of our new long-term growth strategy that we believe will transform our company and drive profitable growth. This strategy focuses on the following areas:

- *Win with Target Customers.* We plan to refocus attention on our target customers, identified through research as 'health enthusiasts' and 'experience seekers', where there is ample opportunity to gain share within these customer segments. Our business can grow by leveraging existing strengths in a unique assortment of better-for-you, quality products and by providing a full omnichannel offering through delivery or pickup via our website or the Sprouts app.
- *Update Format and Expand in Select Markets.* We plan to deliver unique smaller stores with expectations of stronger returns, while maintaining the approachable, fresh-focused farmer's market heritage Sprouts is known for. Our geographic store expansion and new store placement will intersect where our target customers live, in markets with growth potential and supply chain support, providing a long runway of at least 10% annual unit growth beginning in 2022.
- *Create an Advantaged Fresh Supply Chain.* We believe our network of fresh distribution centers can drive efficiencies across the chain and support growth plans. To further deliver on our fresh commitment and reputation, as well as to improve financial results, we will aspire to ultimately position fresh distribution centers within a 250-mile radius of stores.
- *Refine Brand and Marketing Approach.* We believe we can elevate our national brand recognition and positioning by telling our unique brand story rooted in product innovation and differentiation. We are investing savings from removing our print ad into increasing customer engagement through digital and social connections, driving additional sales growth and loyalty.
- *Deliver on Financial Targets and Box Economics.* We will measure and report on the success of this strategy against a number of long-term financial and operational targets, which we believe will result in low double-digit earnings growth.

Our Stores and Operations

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

- *Store Design and Experience.* Our stores are organized in a “flipped” conventional food retail store model, positioning our produce at the center of the store surrounded by a specialty grocery offering. We typically dedicate approximately 20% of a store’s selling square footage to produce, which we believe is significantly higher than many of our peers. The stores are designed with open layouts and low displays, intended to provide an easy-to-shop environment that invokes a farmers’ market experience and allows our customers to view the entire store. Our small box format allows for quick in-and-out service, and our curated assortment of responsibly and locally sourced items offer surprise and delightful shopping experiences.
- *Customer Engagement.* We are committed to providing, and believe we have, best-in-class customer engagement, which builds trust with our customers and differentiates the Sprouts shopping experience from that of many of our competitors. We design our stores to maximize personal connections with our purpose-driven team members, as we believe this interaction provides an opportunity to educate customers and provides a valued, differentiated customer service model, which enhances customer loyalty and increases visits and purchases over time. In addition, we continue to expand mobile and digital opportunities to further engage with our customers and provide a full omnichannel offering as many customers use both in-store and online for their grocery needs.
- *Store Size.* Currently, our stores are generally between 28,000 and 30,000 square feet, which we believe is smaller than many of our peers’ average stores. Under our long-term growth strategy, our future stores will feature a smaller box size, generally between 21,000 and 25,000 square feet, that will be less expensive to build, less complicated to operate and leverage the strengths of our older, highly productive stores. Our stores are located in a variety of mid-sized and larger shopping centers, lifestyle centers and in certain cases, independent single-unit, stand-alone developments. The size of our stores and our real estate strategy provide us flexibility in site selection, including entering into new developments or existing sites formerly operated by other retailers, including other grocery banners, office supply stores, electronics retailers and other second generation space.
- *Team Members.* Our stores are typically staffed with 80 to 100 full and part-time team members. We strive to create a strong and unified company culture and develop team members throughout the entire organization, and we assist our store teams with our store support office and regional teams. We have prioritized making investments in training that we believe enhances our team members’ knowledge, particularly with respect to our expanded and evolving product offerings, so our team members can continue to engage and assist our customers. We believe our team members contribute to our consistently high service standards and that this helps us successfully open and operate our stores.

Our Product Offering

We are a complete natural and organic food retailer that offers a unique shopping experience for our customers. To offer the right assortment of healthy alternatives and good-for-you options, we tailor our assortment to fresh, natural and organic foods and healthier options throughout all of our departments, with innovative products that feature lifestyle friendly ingredients.

Fresh, Natural and Organic Foods

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

Organic foods refer to the food itself as well as the method by which it is produced. In general, organic operations must demonstrate that they are protecting natural resources, conserving biodiversity, and using only approved substances and must be certified by a USDA-accredited certifying agency. Further, retailers that handle, store or sell organic products must implement measures to protect their organic character.

Product Categories

We categorize the varieties of products we sell 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. The following is a breakdown of our perishable and non-perishable sales mix:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Perishables.....	57.2%	57.7%	57.5%
Non-Perishables.....	42.8%	42.3%	42.5%

Departments

While we focus on providing an abundant and affordable offering of natural and organic produce, our stores also include the following departments that enable customers to have a full grocery shopping experience: packaged groceries, meat and seafood, deli, vitamins and supplements, dairy and dairy alternatives, bulk items, baked goods, frozen foods, natural health and body care, and beer and wine. Our departments reflect our intentional curation of responsibly and locally sourced products. We believe each of our departments provides high-quality, differentiated and value-oriented offerings for our customers which we continuously refine with our customer preferences in mind.

Private Label

We have been expanding the breadth of our Sprouts branded products over the last several years and have a dedicated product development team focused on continuing this growth. These products feature competitively priced specialty and innovative products, with great taste profiles and quality and strict ingredient standards that we believe equal or exceed national brands. Our private label program accounted for approximately 16% of our revenue in fiscal 2020 and features approximately 3,500 products. Our private label brands drive value by offering our customers lower prices while still delivering generally higher margin as compared to branded products, as well as an assortment of differentiated, attribute-driven products that are only available at our stores. We believe our private label products build and enhance the Sprouts brand and allow us to distinguish ourselves from our competitors, promoting customer loyalty and creating a destination shopping experience.

Product Innovation

Our stores feature a curated selection of differentiated, innovative products that resonate with our target customers. Since our founding, Sprouts has carried a wide selection of innovative natural and organic brands that align with our mission to inspire healthy living for everyone. Our centralized buying strategy has always put niche brands first, and we have nurtured and grown many once-shoestring brands that now serve as category leaders. As we continue to grow, we are committed to growing our relationships with niche vendors to bring their unique, quality products to the millions of shoppers who visit our stores every week. Sprouts is on the forefront of food innovation and has paved the way for natural food trends for nearly two decades. We embrace product innovation, and our stores serve as an incubator for growth across the natural foods industry.

In 2020, we have launched more than 5,100 new and unique branded and private label products, focused purely on innovation and taste. We feature thousands of responsibly sourced products with certifications and attributes that are desired by our target customer base, including organic, plant-based, fair trade, gluten-free and humane certified. We will continue to lead in product innovation to bring more new, innovative offerings into every department of our stores.

Sourcing and Distribution

We manage the buying of, and set the standards for, the products we sell, and we source our products from hundreds of vendors and suppliers, both domestically and internationally. We are committed to sourcing products in a manner that respects people, our communities and the environment, and we partner with suppliers and service providers that share this commitment, as included in our Supplier Code of Conduct. We work closely with our supply chain partners to improve animal welfare standards, sustainable seafood sourcing, support for organic agriculture and the ethical treatment of people. For an overview of our product sourcing policies and programs, please visit: about.sprouts.com/product-sourcing/.

We believe, based on our industry experience, that our strong relationships in the produce business provide us a competitive advantage and enable us to offer high-quality produce at prices we believe are significantly below those of conventional food retailers and even further below high-end natural and organic food retailers. Our centralized buyers are supported by dedicated regional procurement teams that provide us flexibility to procure produce on local, regional and national levels. Our regional produce buying teams allow us to form meaningful relationships with farmers, and our flexibility allows us to purchase produce in smaller quantities than larger chains to help us bring new and innovative products to our customers before they become commoditized. These products become treasure hunt items found at our stores.

Given the importance of produce to our stores, we source, warehouse and self-distribute nearly all produce. This ensures our produce meets our high-quality standards. We have department and product specifications that ensure a consistently high level of quality across product ingredients, production standards and other key measures of freshness, natural and organic standards. These specifications are measured at both entry and exit points to our facilities. We manage every aspect of quality control in our produce distribution centers.

As a pillar of our long-term growth strategy, we expect to create an advantaged supply chain and aspire to locate our distribution centers within 250 miles of the majority of our stores. We currently have five distribution centers, with two located in California and one located in each of Arizona, Texas and Georgia. In 2021, we expect to open two new distribution centers, one in Colorado and one in Florida. The increased proximity of our distribution centers to our stores will allow us to deliver on our fresh commitment to our customers, source more from products from local farmers and improve efficiencies in our distribution process.

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

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

KeHE Distributors, LLC (“KeHE”), is our primary supplier of dry grocery and frozen food products, accounting for approximately 42%, 40% and 34% of our total purchases in fiscal 2020, 2019 and 2018, respectively. Another 3% of our total purchases in fiscal 2020, 3% of our total purchases in fiscal 2019 and 4% in fiscal 2018, respectively, were made through our secondary supplier, United Natural Foods, Inc. (“UNFI”). See “Risk Factors—Disruption of significant supplier relationships could negatively affect our business.”

Our Pricing, Marketing and Advertising

Pricing

As a farmers market style store, we emphasize low prices throughout the entire store, as we are able to pass along the benefits of our scale and purchasing power to our customers. We position our prices with everyday value for our customers with regular promotions that drive traffic and trial.

Marketing and Advertising

During 2020 as part of our long-term growth strategy to refine our brand and marketing approach, we launched our new branding campaign: Sprouts, Where Goodness Grows. This campaign, which launched on television, social, digital and radio media, is meant to drive home our farmers market experience by highlighting produce, the heart of our stores, and inspire our target customers to engage with our brand by focusing on our differentiation and innovation.

We believe the launch of our new brand will reach more customers through our story telling on television and digital media than our prior approach of reaching customers by paper flyers, which we largely discontinued in 2020. During 2020, we averaged more than 45 million confirmed views of our weekly digital flyer as compared to our average distribution of the 21 million weekly print flyers in the past. Leveraging digital communications targeted to specific geographic areas also provides us with greater flexibility to offer different promotions and respond to local competitive activity and allows us to make our customers aware of what is new and different in our stores in real time.

We also advertise our sales promotions and tell our unique brand story through the use of outdoor billboards and targeted blogger and influencer programming in specific markets.

We developed and maintain the Sprouts app on which we include digital coupons and in-store scan features, and our website, www.sprouts.com, on which we display our weekly sales flyers, highlight our product offerings and offer special deals. Our website and app also feature online ordering for delivery and pickup. We offer home deliveries from our stores through partner services in all of our markets nationwide, as well as “click and collect” pickup service at all of our stores which we quickly launched in 2020 in response to the COVID-19 pandemic. We continue to expand our social media platform. As of January 3, 2021, we had approximately 1.9 million social media followers, primarily on Facebook and Instagram, to promote our brand. We also maintain a network of more than 100 social influencers across the country who receive special mobile coupons to try new products each month. We will continue to explore mobile and digital opportunities to further connect with our customers and leverage data for better customer insights.

Our Customers

We have employed deep research to understand our target customer, what occasions drive purchases, what they buy and where they buy it. Our research yielded a better understanding that our target customer is comprised of two specific groups: health enthusiasts and experience seekers, and we will focus on these groups in our long-term growth strategy.

Our target customer seeks better-for-you grocery options and innovative, quality products to support their healthy lifestyle. We believe they are engaged and connected to what they eat – how it makes them feel, where it comes from and the role it can play in their lives. Our target customer covers a wide range of incomes and age demographics – from Baby Boomers to Generation Z – and seek a variety of healthy and organic options in addition to a great store experience. We believe we only serve a small portion of these target customers at present and have an opportunity to gain a larger proportion of their market share of food-at-home purchases by targeting and identifying those innovative, attribute-driven, quality products and providing the in-store experience and support in living a healthy lifestyle that they are seeking.

Sustainability and Social Responsibility

Central to our identity is a genuine commitment to social and environmental responsibility. We care deeply about the health and well-being of our customers, team members, communities and our planet. We work collaboratively with our supply chain partners, community organizations, and industry experts to understand our material impacts and prioritize where we direct our environmental efforts to maximize our influence. Core areas of focus for us include hunger relief and waste management, carbon emissions reduction related to in-store energy and refrigeration and transportation.

For more information on our sustainability and social responsibility efforts, please visit about.sprouts.com/sustainability/.

The Sprouts Healthy Communities Foundation

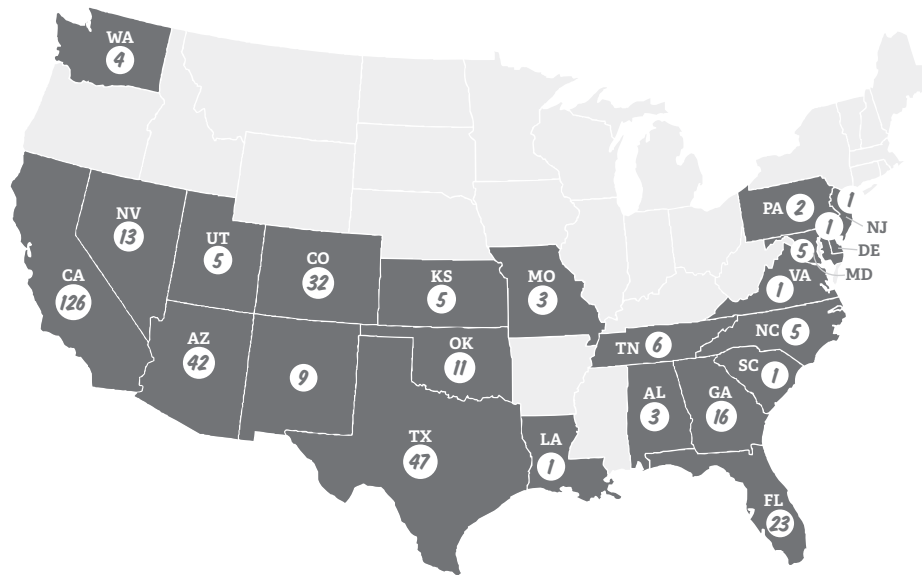
In 2015, we formed the Sprouts Healthy Communities Foundation (referred to as our “Foundation”), a registered 501(c)(3) organization focused on promoting nutrition education and increasing access to fresh, nutritious food in communities where Sprouts operates. Since the Foundation’s inception, it has provided \$12 million in donations to more than 250 non-profit organizations. Sprouts fully funds the Foundation’s programs directly. For more information on our Foundation, please visit about.sprouts.com/sprouts-foundation/.

Growing Our Business

As part of our long-term growth plan, we plan to expand our store base with at least 10% annual unit growth beginning in 2022. Our geographic store expansion and new store placement will intersect where our target customers live, in markets with growth potential and supply chain support, providing a long runway for us to achieve our growth target.

We intend to continue to focus our growth on areas where we have a large concentration of stores, such as California and Texas, while building out our newer markets, such as Florida and the Mid-Atlantic region, to achieve a larger concentration of stores. We have opened 22, 28 and 30 new stores in fiscal 2020, 2019 and 2018, respectively. We expect to continue to expand our store base with approximately 20 store openings planned for fiscal 2021. Beyond 2021, we expect to begin targeting at least 10% annual unit growth.

The below diagram shows our store footprint, by state, as of January 3, 2021.



We will measure the success of our growth strategy against the following long-term targets:

- New store cost to build reduced by approximately 20%;
- New store cash on cash returns of approximately 40%;
- At least 10% unit growth annually, beginning in 2022; and
- Low single-digit comparable store sales growth.

We believe that achieving these targets will generate low double-digit earnings growth.

New Store Development

We have an extensive process for new store site selection, which includes in-depth analysis of area demographics, competition, growth potential, traffic patterns, grocery spend and other key criteria. We have a dedicated real estate team as well as a real estate committee that includes certain of our executive officers. Multiple members of this committee often conduct an on-site inspection prior to approving any new location.

We have been successful across a variety of urban, suburban and rural locations in diverse geographies, from coast to coast, which we believe supports the portability of the Sprouts brand and store model into a wide range of markets. As we implement our long-term growth strategy, our future stores will feature a smaller box size than our recent vintages, generally between 21,000 and 25,000 square feet. By reducing our store square footage, we expect that our newer stores will have a lower cost to build and decreased occupancy and operating costs, while reducing non-selling space that will result in generally flat sales compared to our larger stores. These cost reductions will allow us to deliver strong returns and continue to accelerate our growth.

See “Item 2. Properties” for additional information with respect to our store locations.

Seasonality

Our business is subject to modest seasonality. Our average weekly sales per store fluctuate throughout the year and are typically highest in the first half of the fiscal year and lowest during the fourth quarter.

COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, and on March 13, 2020, the United States declared the pandemic to be a national emergency. As COVID-19 has continued to spread, the situation has continued to evolve, including, in particular, the surge in positive COVID-19 cases in various states around the country during the fourth quarter of 2020 and the first quarter of 2021 as state economies have largely reopened. Our results of operations for the year ended January 3, 2021 have benefited from increased demand from our customers initially stockpiling groceries and wellness products at the onset of the pandemic and continuing to consume more food at home as restaurants have not fully reopened to pre-pandemic levels, and we in turn have made significant investments in compensation, benefits and personal protective equipment for our front-line store team members, as well as enhanced store sanitation procedures. We have also incurred increased ecommerce fees as consumers have increasingly used online shopping alternatives to purchase our products during the pandemic. However, the ultimate impact of the COVID-19 pandemic on our results of operations for future periods will ultimately depend on the length and severity of the pandemic, the efficacy and adoption of the COVID-19 vaccines and governmental and consumer actions taken in response, which we cannot predict. These uncertainties make it challenging for our management to estimate our future business performance. See “Item 1A. Risk Factors— The coronavirus (COVID-19) pandemic has disrupted our business and could negatively impact our financial condition.” for additional information.

Our Competition and Industry

We operate within the competitive and highly fragmented grocery store industry which encompasses a wide array of food retailers, including large conventional independent and chain supermarkets, warehouse clubs, small grocery and convenience stores, and natural and organic, specialty, mass, discount and other food retail and online formats. Based on our industry experience, we believe we are capturing significant market share from conventional supermarkets and specialty concepts in the supermarket segment.

Conventional supermarket customers are attracted to unique product offerings, formats and differentiated shopping experiences. Based on our industry experience, we also believe consumers are increasingly focused on health and wellness and are actively seeking healthy foods in order to improve eating habits. This overall demand for healthy products is driven by many factors, including increased awareness about the benefits of eating healthy, a greater focus on preventative health measures, and the rising costs of health care. We believe customers are attracted to retailers with comprehensive health and wellness product offerings. As a result, food retailers are offering an increased assortment of fresh, natural and organic foods as well as vitamins and supplements to meet this demand.

Our competitors include conventional supermarkets such as Kroger, Albertsons and Safeway, and other food retailers such as Whole Foods, Natural Grocers by Vitamin Cottage and Trader Joe’s, as well as mass or discount retailers, warehouse membership clubs, online retailers such as Amazon, specialty stores, restaurants, and home delivery and meal solution companies. We believe Sprouts offers consumers a compelling value relative to our competitors and will continue to benefit from increasing consumer focus on health, wellness and value, as well as their emphasis on an enhanced shopping experience featuring a broad selection of products along with exceptional customer engagement.

Insurance and Risk Management

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

Trademarks and Other Intellectual Property

We believe that our intellectual property has substantial value and has contributed to the success of our business. In particular, our trademarks, including our registered SPROUTS FARMERS MARKET® and SPROUTS® trademarks, are valuable assets that we believe reinforce our customers' favorable perception of our stores. In addition to our trademarks, we believe that our trade dress, which includes the human-scale design, arrangement, color scheme and other physical characteristics of our stores and product displays, is a large part of the farmers market atmosphere we create in our stores and enables customers to distinguish our stores and products from those of our competitors.

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

Information Technology Systems

We have made significant investments in information technology infrastructure and business systems, including point-of-sale, data warehouse, labor management, purchasing, inventory control, demand forecasting, and financial and reporting systems. Our recent investments have focused on solutions to enhance our operational productivity, optimize our labor, maintain our in-stock positions and forecast our customer demand, while maintaining our high quality and value proposition. All of our stores operate under one integrated information technology platform which allows for our current and future store growth. We will continue making investments in our current information technology infrastructure and invest in systems that scale to support our growth and add efficiencies to our growing operations. In addition, we continue our focused efforts on limiting risk of a cyber-breach by investing in IT security technology tools, resources, penetration assessments, third-party security audits and employee training.

Regulatory Compliance

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

Food. The FDA has comprehensive authority to regulate the safety of food and food ingredients (other than meat, poultry, catfish and certain egg products), as well as dietary supplements under the Federal Food, Drug, and Cosmetic Act ("FDCA"). Similarly, the USDA's Food Safety Inspection Service ("FSIS") is the public health agency responsible for ensuring that the nation's commercial supply of meat,

poultry, catfish and certain egg products is safe, wholesome and correctly labeled and packaged under the Federal Meat Inspection Act and the Poultry Products Inspection Act.

Congress amended the FDCA in 2011 through passage of the Food Safety Modernization Act (“FSMA”), which greatly expanded FDA’s regulatory obligations over all actors in the supply chain. Industry actors continue to determine the best pathways to implement FSMA’s regulatory mandates and FDA’s promulgating regulations throughout supply chains, as most requirements are now in effect. Such regulations mandate that risk-based preventive controls be observed by the majority of food producers. This authority applies to all domestic food facilities and, by way of imported food supplier verification requirements, to all foreign facilities that supply food products.

The FDA and FSIS also exercise broad jurisdiction over the labeling and promotion of food. Labeling is a broad concept that, under certain circumstances, extends even to product-related claims and representations made on a company’s website or similar printed or graphic medium. All foods, including dietary supplements, must bear labeling that provides consumers with essential information with respect to standards of identity, net quantity, nutrition facts labeling, ingredient statement, and allergen disclosures. The agencies also regulate the use of structure/function claims, health claims and nutrient content claims. Additional in-store labeling requirements, such as disclosure of calories and other nutrient information for frequently sold items are now in effect. In addition, various nutrition initiatives that will impact many actors in our supply chain, such as the elimination of certain partially hydrogenated oils and the adoption of a new nutritional labeling format, began to go into effect in 2020.

USDA’s Agricultural Marketing Service (“AMS”) oversees compliance with the National Organic Standards Program and related labeling activity. In addition, AMS has responsibility for newly enacted requirements surrounding the disclosure of the presence of bioengineered ingredients in food, scheduled to become mandatory in 2022.

AMS also enforces the Perishable Agricultural Commodities Act (PACA) which imposes fair business practices on parties engaged in the sale of perishable fruits, vegetables and some nuts. Entities that buy and sell perishable commodities require a PACA license and disputes about sales of produce are subject to rules and regulations under PACA.

Dietary Supplements. The FDA has comprehensive authority to regulate the safety of dietary supplements, dietary ingredients, labeling and current good manufacturing practices. Congress amended the FDCA in 1994 through passage of the Dietary Supplement Health and Education Act (“DSHEA”), which greatly expanded FDA’s regulatory authority over dietary supplements. Through DSHEA, dietary supplements became a separately defined FDA-regulated product that is also subject to the general food regulations. Dietary supplements are allowed to carry structure/function claims which relate to support of healthy functioning. However, no statement on a dietary supplement may expressly or implicitly represent that it will diagnose, cure, mitigate, treat or prevent a disease.

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

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

applicable statutes and regulations, our suppliers and contract manufacturers have from time to time reformulated, eliminated or relabeled certain of their products and we have revised certain provisions of our sales and marketing program.

Human Capital Management

At Sprouts, we are proud of our “People Powered, Purpose Driven” culture focused on improving the health of the communities we serve. Customer engagement is critical to our culture and growth plans, and we place great importance on recruiting candidates and retaining team members that have a love of food, pride themselves on service excellence, and share our purpose driven culture. We build on our targeted recruitment efforts with robust training on customer engagement and product knowledge to ensure there is friendly, knowledgeable staff in every store. As of January 3, 2021, we had approximately 33,000 team members. None of our team members are subject to collective bargaining agreements. We consider our relations with our team members to be good, and we have never experienced a strike or significant work stoppage.

2020 Highlights. Despite the challenges that occurred during 2020 related to the COVID-19 pandemic, we are proud of the following achievements during the year:

- As one of the fastest growing retailers in the country, we created 2,500 new jobs in 2020.
- Additionally, we promoted 7,200 team members and filled 72% of store manager positions with internal candidates.
- Team members saved approximately \$20.0 million through store discounts.
- Awarded 75 scholarships to team members and dependents, equating to more than \$1.4 million in scholarships since our scholarship program began.
- Sprouts was once again recognized as one of Fortune’s World’s Most Admired Companies® in 2020, ranking third in the Food & Drugstores category.

COVID-19 Response. Our store team members have served on the front lines of the COVID-19 pandemic, working diligently under difficult circumstances to ensure our stores were open to our communities so our customers had access to healthy food to feed their families. We implemented the following measures to protect and reward our store team members for their extraordinary efforts:

- From March through September 2020, we provided our store team members with \$2 per hour bonus payments. In the fourth quarter of 2020, we returned to our standard quarterly store bonus plan and added an incremental bonus potential based on store sales metrics.
- We guaranteed quarterly bonus payments for salaried store positions.
- We provided our team members with up to 14 additional days of paid sick or quarantine time due to COVID-19 exposure, as well as 14 days of paid time off for team members considered high-risk by the Center for Disease Control (CDC).
- We hired a team dedicated to navigating team members through positive cases in our stores.
- We established a COVID-19 disaster relief fund available for team members in need.
- Our benefit plans covered 100% of COVID-19 testing costs, and we reimbursed testing costs for team members without benefits coverage.
- We provided additional support through our existing back-up daycare program for eligible team members and relaxed our attendance policy in recognition of the challenges caused by the pandemic.
- We implemented daily health screen and temperature checks for all team members.

- To provide a safe working environment for our team members and our customers, we increased sanitation protocols, secured personal protective equipment for our team members, installed plexiglass at all registers and implemented social distancing and mask protocols at our stores.
- We are offering our team members up to four hours of paid time off to receive the COVID-19 vaccine.

Total Rewards. We are proud to offer our team members competitive pay, store discounts, and opportunities for professional growth. We regularly assess prevailing wages in the markets in which we operate and offer competitive wages and benefits as we believe engaged team members contribute to consumer satisfaction. Our total rewards program features the following:

- We have a quarterly bonus plan for which all store team members are eligible, and during 2020, we have increased the bonus amounts our team members can earn based on store performance.
- We offer a paid sick time policy for all team members and offer generous leave programs.
- Beginning in 2021, all hourly team members are eligible for semi-annual reviews and merit increases.
- We offer team members the opportunity to participate in the Western Association of Food Chains' Retail Management Certificate Program that provides the core skills and knowledge to move into a management role in the retail industry. During 2020, 120 Sprouts team members enrolled in this program.
- We offer The Henry Boney Memorial Scholarship, which is designed to offer team members or their dependents a \$2,000 scholarship to achieve their college dreams.
- All team members over 18 can enroll in our 401(k) plan the first of the month following three months of service, and we offer a contribution matching program.
- We offer a variety of medical plans to allow team members the ability to choose the best plan for them and their families.
- We offer a well-being program dedicated to the mental, physical, emotional and financial well-being of our team members.
- All Sprouts team members can save at our stores, with a 15% Work Perk Discount that can increase to 20% with a simple annual wellness check.

Education, Training and Safety. We believe Sprouts is an attractive place to work with significant growth opportunities for our approximately 33,000 team members. To grow the next generation of leaders at Sprouts, we have developed a Leadership Training Model for high-potential internal team members to take their careers to the next level, and to on-board store managers new to Sprouts. In 2020, we had more than 40 Leadership graduates totaling 8,000 hours in training. We have also partnered with an industry-leading virtual reality technology firm to implement cutting-edge virtual reality training in all of our 362 stores in 2020. Our store team members completed over 475,000 hours of in-store training, and due to the COVID-19 pandemic, traditional training programs transitioned to webinars and learning modules.

We are committed to maintaining a safe environment for our team members and customers. Our stores implement various programs to reduce and eliminate hazards, resulting in a safer workplace and improved shopping experience. In 2020, our stores reported a 20% reduction in non-COVID worker compensation claims over the prior year.

Diversity and Inclusion. We pride ourselves on supporting an inclusive, respectful, and caring culture throughout our organization. In 2020, approximately 51% of our team members were female and approximately 48% of our team members were ethnically diverse, which we believe to be in-line or slightly better than our grocery peers. Further, of our promotions across all store roles, 55% were awarded to

female team members and 49% were awarded to ethnically diverse team members. We conduct formal talent review and succession planning to identify top talent and intentionally make hiring and promotional decisions that consider inclusion of underrepresented team members.

Corporate Offices

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

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports, and the Proxy Statement for our Annual Meeting of Stockholders are made available, free of charge, on our investor relations website at *http://investors.sprouts.com/*, as soon as reasonably practicable after such reports have been filed with or furnished to the SEC.

Item 1A. Risk Factors

Certain factors may have a material adverse effect on our business, financial condition and results of operations. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Annual Report on Form 10-K, including our consolidated financial statements and related notes. Any of the following risks could materially and adversely affect our business, results of operations, cash flows, financial condition, or prospects and cause the value of our common stock to decline.

Market and Other External Risks

The coronavirus (COVID-19) pandemic has disrupted our business and could negatively impact our financial condition.

The unprecedented global outbreak of the novel coronavirus (COVID-19) that began in the first quarter of 2020 has disrupted our business and could continue to do so for the foreseeable future until the impact of the pandemic subsides.

Although our grocery store operations are generally deemed “essential” operations by federal, state and local authorities, thereby allowing our stores to remain open despite government mandated stay-at-home or similar shelter-in-place orders, there can be no assurance that our stores will continue to be allowed by governmental authorities to remain open while the COVID-19 pandemic persists or if it worsens. A closure of stores would adversely impact our net sales, and any alleged failure to comply with such orders or any other governmental regulations promulgated in response to the COVID-19 crisis could result in costly litigation, enforcement actions and penalties. Even if our stores remain open, any reimplementing of reduced operating hours and restrictions on the number of customers allowed in our stores at a given time to promote social distancing could negatively impact store traffic. Store traffic may further decline as customers shop less frequently, choose other retail or online outlets to minimize potential exposure to COVID-19 or return to restaurants and other outlets to purchase and consume food as state economies reopen. We have incurred incremental ecommerce fees as more customers adopt our digital solutions.

Although our operations have generally stabilized since the onset of the crisis, the COVID-19 pandemic has strained our entire supply chain, store operations and merchandising functions. We have encountered difficulties and delays in obtaining products from our distributors, delivering products to our stores and adequately staffing our stores and distribution centers. If we are unable to continue to source, transport and stock products in our stores or to maintain adequate staffing levels in our stores and distribution centers due to disruptions caused by the COVID-19 crisis, we will be unable to maintain inventory levels and continue to operate our stores at levels to meet customer demand. Further, if we do not identify and source appropriate products in response to our customers’ evolving needs during the COVID-19 crisis, we may lose existing customers and fail to attract new customers, which could cause our sales to decrease, resulting in a material adverse effect on our business, financial condition, results of operations and cash flows.

We have incurred, and expect to continue to incur, significant costs to support our front-line store team members, including expenses for added labor, store bonuses, government-mandated wage increases, enhanced benefits and safety measures. If, as a result of the impact of the COVID-19 pandemic, we are unable to continue to provide our team members with appropriate compensation and protective measures, we may be unable to retain current or attract new team members to perform necessary functions within our stores and engage with our customers. Because of the increased demand arising from the pandemic, we have been hiring new team members. There is no assurance we will be able to hire sufficient numbers of individuals to meet our needs. In addition, nearly all of our store support team members remain in a remote work environment in an effort to mitigate the spread of COVID-19. Our failure to provide appropriate technological resources and maintain adequate safeguards around our remote work environment could result in loss of productivity and usage errors by our team members or the loss or compromise of confidential customer, team member or company data. In addition, the remote work environment may increase certain risks to our business, including phishing and other cybersecurity attacks.

We have experienced instances of our team members contracting COVID-19 that have generally tracked national trends, and in response, we follow CDC and other health authority guidelines to report positive test results and reduce further transmission. Any widespread transmission of COVID-19 among our team members within a particular store or geographical area might necessitate that we temporarily close impacted stores, which may negatively affect our business and financial condition, as well as the perception of our company. Further, if individuals believe they have contracted COVID-19 in our stores or believe that we have not taken appropriate precautionary measures to reduce the transmission of COVID-19, we may be subject to costly and time-consuming litigation.

Although we have not experienced significant delays to date, our growth plans for 2021 and beyond may be negatively impacted by the COVID-19 pandemic if our new store construction projects are placed on hold or delayed due to restrictions on construction work or constraints on necessary resources, and we expect such delays may be possible for as long as the COVID-19 crisis persists.

Measures taken by governmental authorities to reduce the transmission of COVID-19, including stay-at-home orders and business closures, as well as limited subsequent economic stimulus initiatives, have resulted in wide-scale unemployment and financial hardship for a large portion of the U.S. population. Shifts in demand to lower priced options and reduced traffic from stockpiling in preparation for the pandemic or from consuming less food at home as restaurants and other businesses reopen may negatively impact sales in subsequent periods. The economic fallout of the COVID-19 pandemic on the geographic areas where we operate may adversely affect our business.

The full extent to which the COVID-19 pandemic impacts our business and financial condition will largely depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the pandemic and the actions necessary to contain COVID-19 or treat its impact.

General economic conditions that impact consumer spending or result in competitive responses could adversely affect our business.

The retail food business is sensitive to changes in general economic conditions. In addition to the impact of the COVID-19 pandemic, recessionary economic cycles, increases in interest rates, higher prices for commodities, fuel and other energy, inflation, high levels of unemployment and consumer debt, depressed home values, high tax rates, tariffs and other macroeconomic factors that affect consumer spending and confidence or buying habits may materially adversely affect the demand for products we sell in our stores. As a result, consumers may be more cautious and could shift their spending to lower-priced competition, such as warehouse membership clubs, dollar stores, online retailers or extreme value formats, which could have a material and adverse effect on our operating results and financial condition.

In addition, prolonged inflation or deflation can impact our business. Food deflation across multiple categories, particularly in produce and proteins, could reduce sales growth and earnings if our competitors react by lowering their retail pricing and expanding their promotional activities, which can lead to retail deflation higher than cost deflation that could reduce our sales, gross profit margins and comparable store sales. Food inflation, when combined with reduced consumer spending, could also reduce sales, gross profit margins and comparable store sales. As a result, our operating results and financial condition could be materially adversely affected.

Our failure to compete successfully in our competitive industry may adversely affect our revenues and profitability.

We operate in the competitive retail food industry. Our competitors include supermarkets, natural food stores, mass or discount retailers, warehouse membership clubs, online retailers and specialty stores, as well as restaurants and home delivery and home meal solution providers. These businesses compete with us for products, customers and locations. We compete on a combination of factors, primarily differentiated product selection, quality, convenience, customer engagement, store format, location, price and delivery options. Our failure to offer products or services that appeal to our customers' preferences could lead to a decrease in our sales. To the extent that our competitors offer lower prices or similar products, our ability to maintain profit margins and sales levels may be negatively impacted. In addition, some competitors are aggressively expanding their number of stores or their product offerings,

increasing the space allocated to perishable, prepared and specialty foods, including fresh, natural and organic foods, and enhancing options of engaging with and delivering their products to customers. Some of these competitors may have been in business longer or may have greater financial or marketing resources than we do and may be able to devote greater resources to sourcing, promoting and selling their products. As competition in certain areas or platforms intensifies or competitors open stores or expand delivery options within close proximity to our stores, our results of operations and cash flows may be negatively impacted through a loss of sales, decrease in customer traffic and market share, reduction in margin from competitive price changes or greater operating costs.

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

We have a significant focus on perishable products, including fresh produce and natural and organic products. Sales of produce accounted for approximately 22% and 23% of our net sales in fiscal 2020 and 2019, respectively. Despite temporary challenges related to the COVID-19 pandemic, we have generally not experienced significant difficulty to date in maintaining the supply of our produce and fresh, natural and organic products that meet our quality standards. However, there is no assurance that these products will be available to meet our needs in the future. The availability of such products at competitive prices depends on many factors beyond our control, including the number and size of farms that grow natural or organic crops or raise livestock that meet our quality, welfare and production standards, tariffs and import regulations or restrictions on foreign-sourced products and the ability of our vendors to maintain organic, non-genetically modified or other applicable third-party certifications for such products. Produce is also vulnerable to adverse weather conditions and natural disasters, such as floods, droughts, storms, frosts, wildfires, earthquakes, hurricanes, pestilences and other extreme or abnormal environmental conditions (including the potential effects of climate change), any of which can lower crop yields and reduce crop size and quality. This could reduce the available supply of, or increase the price of, fresh produce, which may adversely impact sales of our fresh produce and our other products that rely on produce as a key ingredient.

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

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

As of January 3, 2021, we operated 126 stores in California, making California our largest market representing 35% of our total stores in fiscal 2020. We also have store concentration in Texas, Arizona and Colorado, operating 47, 42 and 32 stores in those states, respectively, and representing 13%, 12% and 9% of our total stores in fiscal 2020, respectively. As we execute our long-term growth strategy, we may become even more concentrated in these markets. In addition, we source a large portion of our produce from California, ranging from approximately 40% to approximately 70% depending on the time of year. As a result, our business is currently more susceptible to regional conditions than the operations of more geographically diversified competitors, and we are vulnerable to economic downturns in those regions. Any unforeseen events or circumstances that negatively affect these areas in which we have stores or from which we obtain products could materially adversely affect our revenues and profitability. These factors include, among other things, changes in demographics, population and employee bases; regulation; wage increases; changes in economic conditions; floods, prolonged droughts, windstorms such as tornados, cyclones, hurricanes and tropical storms, winter storms or other severe weather conditions (whether or not caused by climate change); and other catastrophic occurrences, such as pandemics, earthquakes or wildfires. Such conditions may result in reduced customer traffic and

spending in our stores, physical damage to our stores, full or partial loss of power in our stores, loss of inventory, closure of one or more of our stores, inadequate work force in our markets, temporary disruption in the supply of products whether from self or third-party distribution, delays in the delivery of goods to our stores and a reduction in the availability of products in our stores. Any of these factors may disrupt our business and materially adversely affect our financial condition, results of operations and cash flows.

Fluctuations in commodity prices and availability may impact profitability.

Many products we sell include ingredients such as wheat, corn, oils, milk, sugar, cocoa, nuts and other key commodities. Many commodity prices are subject to significant fluctuations and may be impacted by tariffs. Any increase in prices of such key ingredients may cause our vendors to seek price increases from us, and price decreases may result in our competitors reducing retail prices on items containing such ingredients. If we are unable to mitigate these fluctuations, our profitability may be impacted either through increased costs to us or lower prices and loss of customers due to competitive conditions, which may impact gross margins, or through reduced revenue as a result of a decline in the number and average size of customer transactions.

A widespread health epidemic or other incidents beyond our control could materially impact our business.

As evidenced by the ongoing COVID-19 pandemic, our business could be severely impacted by other widespread regional, national or global health epidemics or other incidents beyond our control such as terrorism, riots, acts of violence and other crimes. Such events may cause customers to avoid public gathering places such as our stores or otherwise change their shopping behaviors. Additionally, these occurrences could adversely impact our business by disrupting production and delivery of products to our stores and by impacting our ability to appropriately staff our stores.

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

To support our expanding business, we must have sufficient capital to continue to make significant investments in our new and existing stores and advertising. If cash flows from operations are not sufficient, we may need additional equity or debt financing to provide the funds required to expand our business. If such financing is not available on satisfactory terms or at all, we may be unable to expand our business or to develop new business at the rate desired. Debt financing increases expenses, may contain covenants that restrict the operation of our business, and must be repaid regardless of operating results. Equity financing, or debt financing that is convertible into equity, could result in additional dilution to our existing stockholders. Our inability to obtain adequate capital resources, whether in the form of equity or debt, to fund our business and growth strategy may require us to delay, scale back or eliminate some or all of our operations or the expansion of our business, which may have a material adverse effect on our business, operating results, financial condition or prospects.

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

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

Business and Operating Risks

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

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

We opened 22 and 28 stores in fiscal 2020 and 2019, respectively, and we currently expect to open approximately 20 new stores in 2021. Beyond 2021, we expect to achieve 10% annual unit growth, including penetration of new markets with a greater concentration of new stores. However, we may not achieve this expected level of new store growth. We may not have the level of cash flow or financing necessary to support our growth strategy. Additionally, our proposed expansion will place increased demands on our operational, managerial and administrative resources. These increased demands could cause us to operate our existing business less effectively, which in turn could cause deterioration in the financial performance of our existing stores. Further, new store openings in markets where we have existing stores may result in reduced sales volumes at our existing stores in those markets. If we experience a decline in performance, we may slow or discontinue store openings, or we may decide to close stores that we are unable to operate in a profitable manner. If we fail to successfully implement our growth strategy, including by opening new stores, our financial condition, results of operations and cash flows may be adversely affected.

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

We may not be able to achieve or improve the levels of comparable store sales that we have experienced in the past. Our comparable store sales growth could be lower than our historical average for many reasons, including general economic conditions, competition, cycling prior year performance and the other matters discussed in these Risk Factors. These factors may cause our comparable store sales results to be materially lower than in recent periods, which could harm our business and result in a decline in the price of our common stock:

Disruption of significant supplier relationships could negatively affect our business.

KeHE is our primary supplier of dry grocery and frozen food products, accounting for approximately 42% and 40% of our total purchases in fiscal 2020 and 2019, respectively. Our current primary contractual relationship with KeHE continues through July 18, 2025 and provides that KeHE will be our primary supplier for all of our stores. Due to this concentration of purchases from a single third-party supplier, the cancellation of our distribution arrangement or the disruption, delay or inability of KeHE to deliver product to our stores in quantities or within service parameters that meet our requirements may materially and adversely affect our operating results while we establish alternative supply chain channels. Another 3% of our total purchases in both fiscal 2020 and 2019, respectively, were made through our secondary supplier, UNFI. Our current contractual relationship with UNFI continues through September 30, 2021. There is no assurance UNFI or other distributors will be able to fulfill our needs on favorable terms or at all. In addition, if KeHE, UNFI or any of our other suppliers fail to comply with food safety, labeling or other laws and regulations, or face allegations of non-compliance, their operations may be disrupted. Further, the food distribution and manufacturing industries are dynamic. Consolidation of distributors or the manufacturers that supply them could reduce our supply options and detrimentally impact the terms under which we purchase products. We may not be able to find replacement suppliers on commercially reasonable terms, which would have a material adverse effect on our financial condition, results of operations and cash flows.

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

We self-distribute our produce through five distribution centers located in Arizona, Texas, northern California, southern California and Georgia. We also plan to open a new distribution center in Colorado and Florida in 2021. As we further expand our geographic footprint, we may require additional distribution centers. Any unanticipated or unusual expenses or significant interruption or failure in the operation of our distribution center infrastructure, such as disruptions due to fire, severe weather or other catastrophic events, power outages, labor shortages or disagreements, shipping or infrastructure problems, food safety concerns, integration of new distribution centers into our supply chain network, inability of our new distribution centers to perform as expected or contractual disputes with third-party service providers could result in increased expenses and adversely impact our ability to distribute produce and other products to our stores. Such interruptions could result in lost sales and a loss of customer loyalty to our brand, as well as increased costs from third-party service providers. While we maintain business interruption and property insurance, if the operation of our distribution centers or transportation network were interrupted for any reason, causing delays in shipment of produce to our stores, our insurance may not be sufficient to cover losses we experience, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

Disruptions to, security breaches or non-compliance involving, our information technology systems could harm our ability to run our business and expose us to potential liability and loss of revenues.

We rely extensively on information technology systems for point-of-sale processing in our stores, supply chain, financial reporting, human resources and various other processes and transactions. Our information technology systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, including breaches of our transaction processing or other systems that could result in the compromise of confidential customer or team member data, catastrophic events, and usage errors by our team members. We have implemented numerous security protocols in order to strengthen security, and we maintain a customary cyber insurance policy, but there can be no assurance breaches will not occur in the future, be detected in a timely manner or be covered by our insurance policy. Significant expenditures could be required to remedy future cybersecurity problems and protect against future breaches. Additionally, compliance with current and future applicable U.S. privacy, cybersecurity and related laws, including for example the California Privacy Act of 2018 (“CCPA”) and the California Privacy Rights Act (“CPRA”), can be costly and time-consuming. These costs could have a material adverse effect on our business, and our efforts may not meaningfully limit the success of future attempts to breach our information technology systems.

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

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

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

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

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

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

- anticipate, identify and react to fresh, natural and organic grocery and dietary supplement trends and changing consumer preferences and demographics in a timely manner;
- translate market trends into appropriate, saleable product and service offerings in our stores before our competitors; and
- develop and maintain vendor and service provider relationships that provide us access to the newest on-trend merchandise and customer engagement options on reasonable terms.

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

If we are unable to anticipate and satisfy consumer preferences with respect to product offerings and customer engagement options, our sales may decrease, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

We have actively pursued new store growth and plan to continue doing so in the future. Our new store openings may not be as successful or reach the sales and profitability levels of our existing stores. New store openings may negatively impact our financial results in the short-term due to the effect of store

opening costs and lower sales and contribution to overall profitability during the initial period following opening. New stores build their sales volume and their customer base over time and, as a result, generally have lower margins and higher operating expenses, as a percentage of net sales, than our more mature stores. New stores may not achieve sustained sales and operating levels consistent with our more mature store base on a timely basis or at all. This may have an adverse effect on our financial condition and operating results. Further, we have experienced in the past, and expect to experience in the future, some sales volume transfer from our existing stores to our new stores as some of our existing customers switch to new, closer locations. If our new stores are less profitable than our existing stores, or if we experience sales volume transfer from our existing stores, our financial condition and operating results may be adversely affected.

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

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

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

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

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

The loss of key management could negatively affect our business.

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

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

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

wage rates, changing demographics, health and other insurance costs and changes in employment legislation. In the event of increasing wage rates, if we fail to increase our wages competitively, the quality of our workforce could decline, causing our customer engagement to suffer, while increasing our wages could cause our earnings to decrease. If we are unable to hire and retain team members capable of meeting our business needs and expectations, our business and brand image may be impaired. Any failure to meet our staffing needs or any material increase in turnover rates of our team members or team member wages may adversely affect our business, results of operations, cash flows or financial condition.

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

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

Higher wage and benefit costs could adversely affect our business.

Changes in federal and state minimum wage laws and other laws relating to employee compensation and benefits could cause us to incur additional wage and benefit costs, as well as increased contractual costs associated with our service providers. Increased labor costs brought about by changes in minimum wage laws, other regulations or prevailing market conditions would increase our expenses and have an adverse impact on our profitability.

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

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

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

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

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

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

As of January 3, 2021, we had outstanding indebtedness of \$250.0 million under our credit agreement (referred to as the “Amended and Restated Credit Agreement”). We may incur additional indebtedness in the future, including borrowings under our Amended and Restated Credit Agreement. Our indebtedness, any additional indebtedness we may incur, or any hedging arrangements related to such indebtedness could require us to divert funds identified for other purposes for debt service and impair our liquidity position. If we cannot generate sufficient cash flow from operations to service our debt, we may need to refinance our debt, dispose of assets or issue equity to obtain necessary funds. We do not know whether we will be able to take any of such actions on a timely basis, on terms satisfactory to us or at all.

Covenants in our debt agreements restrict our operational flexibility.

Our Amended and Restated Credit Agreement contains usual and customary restrictive covenants relating to our management and the operation of our business, including incurring additional indebtedness; making certain investments; merging, dissolving, liquidating, consolidating, or disposing of all or substantially all of our assets; paying dividends, making distributions, or redeeming capital stock; entering into transactions with our affiliates; and granting liens on our assets.

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

Financial Reporting, Legal and Other Regulatory Risks

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

Enforcement. Both FDA and USDA have broad authority to enforce their applicable provisions relating to the safety, labeling, manufacturing, distribution and promotion of foods and dietary supplements, including powers to issue a public warning letter to a company, publicize information about illegal products, institute an administrative detention of food, request or order a recall of food from the market, and request the Department of Justice to initiate a seizure action, an injunction action or a criminal prosecution.

Dietary Supplement Risks. As a retailer of dietary supplements our sales of dietary supplements are regulated by FDA. However, other public and private actors are increasingly targeting dietary supplement retailers and manufacturers for selling products that fail to adhere to requirements under FDCA, as amended by DSHEA. While FDCA provides FDA with the authority to remove products from the market that are adulterated or misbranded, state actors, and the Plaintiffs’ Bar have been targeting retailers and manufacturers of dietary supplements for failing to adhere to current good manufacturing practices and for false or misleading product statements.

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

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

Organic and GMO Claims. We are also subject to the USDA’s Organic Rule, which facilitates interstate commerce and the marketing of organically produced food, and provides assurance to our customers that such products meet consistent, uniform standards. Compliance with the USDA’s Organic Rule also places a significant burden on some of our suppliers, which may cause a disruption in some of our product offerings. Additionally, the USDA has promulgated regulations that require disclosure of whether food offered for sale contains bioengineered (GMO) ingredients. Implementation began in January 2020.

FSMA Implementation Costs. FSMA directed an historic shift at FDA from the Agency reacting to and solving problems in the food supply chain to preventing contamination of food before it occurs. FSMA accomplished this goal by overhauling FDA’s current food safety program by requiring all actors in the food supply chain to expand their safety programs and record keeping processes. FSMA’s continued implementation and FDA’s own development in understanding effective ways to enforce FSMA provisions could delay the supply of certain products or result in certain products being unavailable to us for sale in our stores.

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

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

We are subject to laws and regulations more generally applicable to retailers, including labor and employment, taxation, zoning and land use, environmental protection, workplace safety, public health, community right-to-know, consumer protection and alcoholic beverage sales. Due to the COVID-19 pandemic, we are subject to additional governmental regulations and health guidelines, as well as other voluntary safety protocols. Our stores are subject to unscheduled inspections on a regular basis, which, if violations are found, could result in the assessment of fines, suspension of one or more needed licenses and, in the case of repeated “critical” violations, closure of the store until a re-inspection demonstrates that we have remediated the problem. Further, our new store openings could be delayed or prevented, or our existing stores could be impacted by difficulties or failures in our ability to obtain or maintain required approvals or licenses. In addition, we are subject to environmental laws pursuant to which we could be held responsible for all of the costs or liabilities relating to any contamination at our or our predecessors’ past or present facilities and at third-party waste disposal sites, regardless of our knowledge of, or responsibility for, such contamination, and such costs may exceed our environmental liability insurance coverage.

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

We cannot predict the nature of future laws, regulations, interpretations or applications, or determine what effect either additional government regulations or executive or administrative orders, when and if promulgated, or disparate federal, state and local regulatory schemes would have on our business in the future. They could, however, increase our costs; result in our unintended misinterpretation or noncompliance; expose us to litigation; require the reformulation of certain products or alternative sourcing from domestic suppliers or otherwise to meet new standards, regulations or trade restrictions; require the recall or discontinuance of certain products not able to be reformulated or alternatively sourced in compliance with new regulations or restrictions; impose additional recordkeeping; expand documentation of the properties of certain products; necessitate expanded or different labeling and/or scientific substantiation; or require us to discontinue certain operations. Any or all of such requirements could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

Our operations, which are characterized by a high volume of customer traffic and data collection and by transactions involving a wide variety of product selections, carry a higher exposure to consumer litigation risk when compared to the operations of companies operating in some other industries. Consequently, we may be a party to individual personal injury, product liability, intellectual property, data privacy and other legal actions in the ordinary course of our business, including litigation arising from the COVID-19 pandemic, food-related illness or product labeling. In addition, our team members may, from time to time, bring lawsuits against us regarding injury, hostile work environment, discrimination, wage and hour disputes, sexual harassment, or other employment issues. In recent years, there has been an increase in the number of discrimination and harassment claims across the United States generally. The outcome of litigation, particularly class action lawsuits, is difficult to assess or quantify. Plaintiffs in these types of lawsuits may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to such lawsuits may remain unknown for substantial periods of time. While we maintain insurance, insurance coverage may not be adequate, and the cost to defend against future litigation may be significant. There may also be adverse publicity associated with litigation that may decrease consumer confidence in or perceptions of our business, regardless of whether the allegations are valid or whether we are ultimately found liable. As a result, litigation may materially adversely affect our business, financial condition, results of operations and cash flows.

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

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

We may also be subject to claims that our intellectual property, activities or the products we sell infringe, misappropriate or otherwise violate the intellectual property rights of others. Any such claims can be time consuming and costly to defend and may distract management's attention and resources, even if the claims are without merit. Such claims may also require us to enter into costly settlement or license agreements (which could, for example, prevent us from using our trademarks in certain geographies or in connection with certain products and services), pay costly damage awards, and face a temporary or permanent injunction prohibiting us from marketing or providing the affected products and services, any of which could have a material adverse effect on our business.

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

Accounting principles generally accepted in the United States and related accounting pronouncements, implementation guidelines, and interpretations for many aspects of our business, such as accounting for leases, inventories, goodwill and intangible assets, store closures, insurance, income taxes, share-based compensation and accounting for mergers and acquisitions and other special items, are complex and involve subjective judgments. Changes in these rules or their interpretation may necessitate changes to our financial statement presentation and significantly change or add significant volatility to our reported earnings without a comparable underlying change in cash flow from operations. As a result, changes in accounting standards may materially impact our reported financial condition and results of operations. For example, our adoption of ASC 842, *Leases*, effective in fiscal 2019 impacted our financial statement presentation and financial results.

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

As a public company, we are required to maintain internal control over financial reporting. If we are unable to maintain effective internal control over financial reporting, if we identify any material weaknesses therein, if we are unsuccessful in our efforts to remediate any such material weakness, if our management is unable to report that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively

affected. In addition, we could become subject to investigations by the NASDAQ Stock Market, the SEC, or other regulatory authorities, which could require additional financial and management resources.

If our goodwill or other intangible assets become impaired, we may be required to record a significant charge to earnings.

We have a significant amount of goodwill and other intangible assets. As of January 3, 2021, we had goodwill and intangible assets of approximately \$368.9 million and \$185.0 million, respectively, which represented approximately 13% and 7% of our total assets as of such date, respectively. Goodwill is reviewed for impairment on an annual basis in the fourth fiscal quarter or whenever events occur or circumstances change that would more likely than not reduce the fair value of our reporting unit below its carrying amount. Fair value is determined based on the discounted cash flows and the market value of our single reporting unit. If the fair value of the reporting unit is less than its carrying value, the fair value of the implied goodwill is calculated as the difference between the fair value of our reporting unit and the fair value of the underlying assets and liabilities, excluding goodwill. In the event an impairment to goodwill is identified, an immediate charge to earnings in an amount equal to the excess of the carrying value over the implied fair value would be recorded, which would adversely affect our operating results.

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

We provide nutrition-oriented education to our customers, and these activities may be subject to state and federal regulation and oversight by professional organizations or misconstrued by our customers as medical advice. In the past, the FDA has expressed concerns regarding summarized health and nutrition-related information that (i) does not, in the FDA's view, accurately present such information, (ii) diverts a consumer's attention and focus from FDA-required nutrition labeling and information or (iii) impermissibly promotes drug-type disease-related benefits. If our team members or third parties we engage to provide this information do not act in accordance with regulatory requirements, we may become subject to penalties or litigation that could have a material adverse effect on our business. We believe we are currently in compliance with relevant regulatory requirements. However, we cannot predict the nature of future government regulation and oversight, including the potential impact of any such regulation on this activity. Furthermore, the availability of professional liability insurance or the scope of such coverage may change, or our insurance coverage may prove inadequate, which may adversely impact the ability of our customer educators to provide some information to our customers. The occurrence of any such developments could negatively impact the perception of our brand, our sales and our ability to attract new customers.

Common Stock Ownership Risks

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

There is no guarantee that our common stock will appreciate in value or even maintain the price at which our stockholders have purchased their shares. The trading price of our common stock may be volatile and subject to wide price fluctuations in response to various factors, many of which are beyond our control. Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These and other factors may cause the market price and demand for our common stock to fluctuate substantially, which may limit or prevent investors from readily selling their shares of common stock and may otherwise negatively affect the price or liquidity of our common stock. In addition, in the past, when the market price of a stock has been volatile, holders of that stock have sometimes instituted securities class action litigation against the company that issued the stock. If any of our stockholders were to bring a lawsuit against us, we could incur substantial costs defending the lawsuit or paying for settlements or damages. Such a lawsuit could also divert the time and attention of our management from our business.

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

Certain provisions of our certificate of incorporation and bylaws and applicable provisions of Delaware law may have the effect of rendering more difficult, delaying, or preventing an acquisition of our company, even when this would be in the best interest of our stockholders. These include, without limitation, the following provisions:

- a classified board of directors (referred to as the “Board”) whose members serve staggered three-year terms;
- “blank check” preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend, and other rights superior to our common stock;
- inability of our stockholders to call special meetings of stockholders, which may delay the ability of our stockholders to force consideration of a proposal or the ability of holders controlling a majority of our capital stock to take any action, including the removal of directors; and
- required advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to the board.

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

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

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

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

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

Our business could be impacted as a result of actions by activist stockholders or others.

We may be subject, from time to time, to legal and business challenges in the operation of our company due to actions instituted by activist shareholders or others. Responding to such actions, which may include private engagement, publicity campaigns, proxy contests, efforts to force transactions not supported by our Board, and litigation, could be costly and time-consuming, may not align with our strategic plan and could divert the time and attention of our Board and management from our business. Perceived uncertainties as to our future direction as a result of stockholder activism may lead to the perception of a change in the direction of the business or other instability and may affect our stock price, relationships with vendors, customers, prospective and current team members and others.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We seek to select sites for our store locations in markets with growth potential where our target customers and supply chain capabilities intersect. As of January 3, 2021, we had 362 stores located in twenty-three states, as shown in the chart below:

<u>State</u>	<u>Number of Stores</u>	<u>State</u>	<u>Number of Stores</u>
Alabama	3	New Jersey	1
Arizona	42	New Mexico	9
California	126	North Carolina	5
Colorado	32	Oklahoma	11
Delaware	1	Pennsylvania	2
Florida	23	South Carolina	1
Georgia	16	Tennessee	6
Kansas	5	Texas	47
Louisiana	1	Utah	5
Maryland	5	Virginia	1
Missouri	3	Washington	4
Nevada	13		

In fiscal 2019, we opened 28 new stores and closed one underperforming store. In fiscal 2020, we opened 22 new stores.

We lease all of our stores from unaffiliated third parties. A typical store lease is for an initial 10 to 15 year term with three or four renewal options of five years each. We expect that we will be able to renegotiate these leases or relocate these stores as necessary. In addition to new store openings, we remodel or relocate stores periodically in order to improve performance. See “Business – New Store Development” for additional information with respect to our store site selection process.

As of January 3, 2021, we utilized five distribution centers. Information about such facilities, as well as our current corporate office in Phoenix, Arizona, is set forth in the table below:

<u>Facility</u>	<u>State</u>	<u>Square Footage*</u>
Corporate Office	Arizona	96,000
Distribution Center	Arizona	129,000
Distribution Center	California	123,000
Distribution Center	California	110,000
Distribution Center	Georgia	100,000
Distribution Center	Texas	117,000

* Rounded to the nearest 1,000 square feet

We lease our corporate office and our distribution centers in Arizona and Texas from unaffiliated third parties; our remaining three distribution centers are leased or owned by our third-party logistics providers. We expect to open a new distribution center in Colorado and Florida in 2021. See “Business – Sourcing and Distribution” for additional information with respect to our distribution centers.

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

Item 3. *Legal Proceedings*

From time to time we are a party to legal proceedings, including matters involving personnel and employment issues, product liability, personal injury, intellectual property and other proceedings arising in the ordinary course of business, which have not resulted in any material losses to date. Although our 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.

See Note 19, “Commitments and Contingencies” to our Consolidated Financial Statements for information regarding certain legal proceedings in which we are involved.

Item 4. *Mine Safety Disclosures*

Not applicable.

PART II

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

Market Information

Our common stock began trading on the NASDAQ Global Select Market under the symbol "SFM" on August 1, 2013. The number of stockholders of record of our common stock as of February 23, 2021 was 28. This number excludes stockholders whose stock is held in nominee or street name by brokers.

Dividend Policy

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

Issuer Purchases of Equity Securities

There was no share repurchase activity during the fourth fiscal quarter of 2020 ended January 3, 2021.

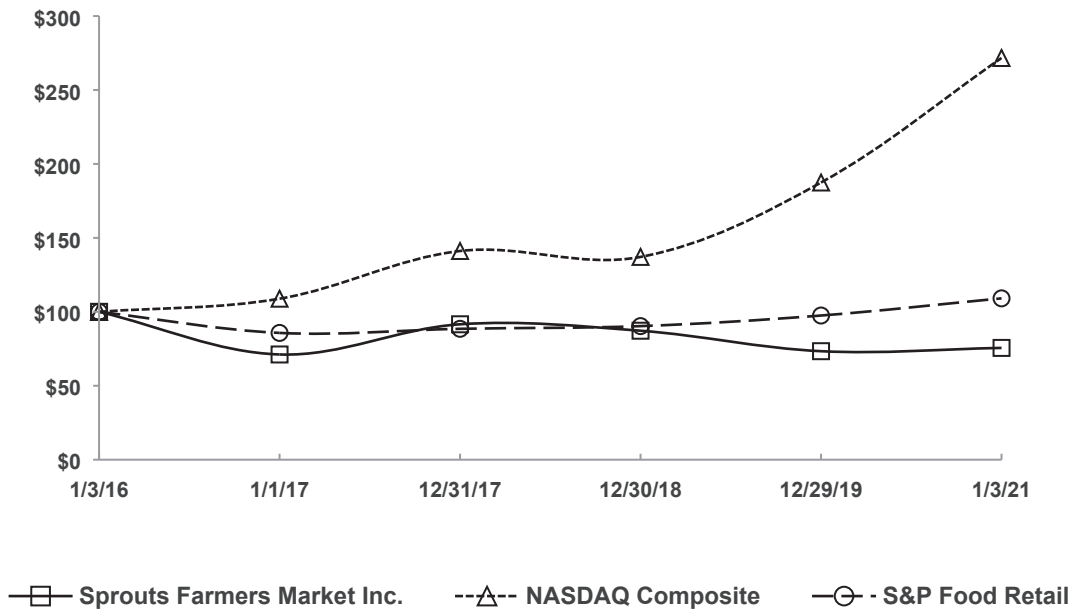
Performance Graph

The graph set forth below compares the cumulative total stockholder return on our common stock between January 3, 2016 and January 3, 2021, with the cumulative total return of (i) the Nasdaq Composite Index and (ii) the S&P Food Retail Index, over the same period.

The comparison assumes that \$100.00 was invested in our common stock, the Nasdaq Composite Index and the S&P Food Retail Index, and assumes reinvestment of dividends, if any. The graph assumes the initial value of our common stock on January 3, 2016 was the closing sale price on that day of \$26.59 per share. The performance shown on the graph below is based on historical results and is not intended to suggest future performance.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Sprouts Farmers Market Inc., the NASDAQ Composite Index and the S&P Food Retail Index



*\$100 invested on 1/3/16 in stock or 12/31/15 in index, including reinvestment of dividends. Indexes calculated on month-end basis.

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

Item 6. Selected Financial Data

Set out below is selected financial data for and as of the end of fiscal 2016 through fiscal 2020. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Components of Operating Results” and Note 3, “Significant Accounting Policies”, to our Consolidated Financial Statements for more information.

	Fiscal 2020 ⁽²⁾	Fiscal 2019 ⁽¹⁾	Fiscal 2018 ⁽¹⁾	Fiscal 2017 ⁽¹⁾	Fiscal 2016 ⁽¹⁾
(dollars in thousands, except per share data)					
Statements of Income Data:					
Net sales	\$6,468,759	\$5,634,835	\$5,207,336	\$4,664,612	\$4,046,385
Cost of sales	4,089,470	3,740,017	3,459,861	3,097,582	2,682,937
Gross profit	2,379,289	1,894,818	1,747,475	1,567,030	1,363,448
Selling, general and administrative expenses	1,863,869	1,549,707	1,404,443	1,245,640	1,071,995
Depreciation and amortization (exclusive of depreciation included in cost of sales).....	124,124	120,491	108,045	94,194	78,293
Store closure and other costs, net ⁽³⁾	(369)	7,260	12,076	1,126	228
Income from operations	391,665	217,360	222,911	226,070	212,932
Interest expense, net	14,787	21,192	27,435	21,177	14,794
Other income	—	—	320	625	454
Income before income taxes.....	376,878	196,168	195,796	205,518	198,592
Income tax provision ⁽⁴⁾	89,428	46,539	37,260	47,078	74,286
Net income.....	<u>\$ 287,450</u>	<u>\$ 149,629</u>	<u>\$ 158,536</u>	<u>\$ 158,440</u>	<u>\$ 124,306</u>
Per Share Data:					
Net income per share—basic	\$ 2.44	\$ 1.25	\$ 1.23	\$ 1.17	\$ 0.84
Net income per share—diluted	\$ 2.43	\$ 1.25	\$ 1.22	\$ 1.15	\$ 0.83
Weighted average shares outstanding—basic	117,821	119,368	128,827	135,169	147,311
Weighted average shares outstanding—diluted	118,224	119,742	129,776	137,884	149,653
As of					
	Fiscal 2020 ⁽²⁾	Fiscal 2019 ⁽¹⁾	Fiscal 2018 ⁽¹⁾	Fiscal 2017 ⁽¹⁾	Fiscal 2016 ⁽¹⁾
Balance Sheet Data					
Total assets ⁽⁵⁾	\$2,806,404	\$2,722,983	\$1,675,614	\$1,581,603	\$1,439,893
Long-term obligations, including capital, financing and finance lease obligations ⁽⁶⁾	260,459	549,419	572,642	473,489	372,366
Total stockholders’ equity	881,293	581,952	589,196	650,694	672,909

	Fiscal 2020 ⁽²⁾	Fiscal 2019 ⁽¹⁾	Fiscal 2018 ⁽¹⁾	Fiscal 2017 ⁽¹⁾	Fiscal 2016 ⁽¹⁾
Comparable store sales growth	6.9%	1.1%	2.1%	2.9%	2.7%
Stores at end of period	362	340	313	285	253
Other Operating Data:					
Stores at beginning of period	340	313	285	253	217
Opened ⁽⁷⁾	22	28	30	32	36
Closed	—	(1)	(2)	—	—
Stores at end of period.....	362	340	313	285	253
Gross square feet at end of period.....	10,511,720	9,846,081	9,029,768	8,054,720	7,070,248
Average store size at end of period (gross square feet)	29,038	28,959	28,849	28,262	27,946

Note: This information should be read in conjunction with Management's Discussion and Analysis and the consolidated financial statements and footnotes.

- (1) Fiscal 2016, 2017, 2018, and 2019 included 52 weeks.
- (2) Fiscal 2020 included 53 weeks.
- (3) Fiscal 2020 store closure and other costs, net included a recognized gain on the assignment of the lease of one of our closed locations. Fiscal 2019 store closure and other costs, net included \$4.1 million in one-time charges associated with impairment charges of long-lived assets and a one-time severance expense of \$1.2 million associated with the transition of our former President and Chief Operating Officer to Senior Advisor. Fiscal 2018 store closure and other costs, net included \$8.0 million in non-cash one-time charges associated with lease termination obligations and asset disposals for two closed stores, as well as a one-time severance expense of \$3.6 million associated with the resignation of our former Chief Executive Officer.
- (4) Fiscal 2018 income tax provision included a \$2.6 million discrete tax benefit due to a tax calculation method change that resulted in the accelerated deduction or deferral of certain items and a \$12.4 million benefit related to excess tax benefits on share-based compensation. Fiscal 2017 income tax provision included an \$18.7 million benefit related to the implementation of the Tax Cuts and Jobs Act in the fourth quarter and a \$9.9 million benefit related to excess tax benefits on share-based compensation.
- (5) Fiscal 2019 and 2020 total assets included right-of-use assets in accordance with ASC 842.
- (6) For fiscal years 2016-2018, long-term obligations included capital and financing lease obligations under ASC 840. For fiscal years 2019 and 2020, long-term obligations included finance leases under ASC 842.
- (7) Stores opened were exclusive of one store relocation during fiscal 2016 and 2019.

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

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

Business Overview

Sprouts Farmers Market offers a unique grocery experience featuring an open layout with fresh produce at the heart of the store. Sprouts inspires wellness naturally with a carefully curated assortment of better-for-you products paired with purpose-driven people. We continue to bring the latest in wholesome, innovative products made with lifestyle-friendly ingredients such as organic, plant-based and gluten-free. Since our founding in 2002, we have grown rapidly, significantly increasing our sales, store count and profitability. Headquartered in Phoenix with 362 stores in 23 states as of January 3, 2021, we are one of the largest specialty retailers of fresh, natural and organic food, and fastest growing retailers in the United States.

Our Heritage

In 2002, we opened the first Sprouts Farmers Market store in Chandler, Arizona. From our founding in 2002 through January 3, 2021, we have grown rapidly, significantly increasing our sales, store count and profitability, including 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

In 2020, we announced the initial steps of our new long-term growth strategy that we believe will transform our company and drive profitable growth. This strategy focuses on the following areas:

- *Win with Target Customers.* We plan to refocus attention on our target customers, where there is ample opportunity to gain share within these customer segments. Our business can grow by leveraging existing strengths in a unique assortment of better-for-you, quality products and by expanding ecommerce capabilities to allow customers easy access to differentiated products through delivery or pickup.
- *Update Format and Expand in Select Markets.* We plan to deliver unique smaller stores with expectations of stronger returns, while maintaining the approachable, fresh-focused farmer’s market heritage Sprouts is known for. Our geographic store expansion and new store placement will intersect where our target customers live, in markets with growth potential and supply chain support, providing a long runway of at least 10% annual unit growth beginning in 2022.

- *Create an Advantaged Fresh Supply Chain.* We believe our network of fresh distribution centers can drive efficiencies across the chain and support growth plans. To further deliver on our fresh commitment and reputation, as well as to improve financial results, we will aspire to ultimately position fresh distribution centers within a 250-mile radius of stores.
- *Refine Brand and Marketing Approach.* We believe we can elevate our national brand recognition and positioning by telling our unique product innovation and differentiation story. Increased customer engagement through digital and social connections will drive additional sales growth and loyalty.
- *Deliver on Financial Targets and Box Economics.* We will measure and report on the success of this strategy against a number of long-term financial and operational targets.

Components of Operating Results

We report our results of operations on a 52- or 53-week fiscal year ending on the Sunday closest to December 31, with each fiscal quarter generally divided into three periods consisting of two four-week periods and one five-week period. Fiscal 2020 was a 53-week year ending on January 3, 2021. Fiscal 2019 was a 52-week year ending on December 29, 2019, and fiscal 2018 was a 52-week year ending on December 30, 2018.

Net Sales

We recognize sales revenue at the point of sale, with discounts provided to customers reflected as a reduction in sales revenue. Proceeds from sales of gift cards are recorded as a liability at the time of sale and recognized as sales when they are redeemed by the customer. See Note 3, “Significant Accounting Policies” for additional information on revenue recognition related to gift cards. We do not include sales taxes in net sales.

We monitor our comparable store sales growth to evaluate and identify trends in our sales performance. Our practice is to include sales from a store in comparable store sales beginning on the first day of the 61st week following the store’s opening and to exclude sales from a closed store from comparable store sales on the day of closure. This practice may differ from the methods that other retailers use to calculate similar measures.

Our net sales have increased as a result of new store openings and comparable store sales growth. Factors that influence comparable store sales growth and other sales trends include:

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

Cost of sales and gross profit

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

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

Selling, general and administrative expenses

Selling, general and administrative expenses primarily consist of salaries, wages and benefits costs, share-based compensation, store occupancy costs (including rent, property taxes, utilities, common area maintenance and insurance), advertising costs, buying cost, pre-opening and other administrative costs.

Depreciation and Amortization

Depreciation and amortization (exclusive of depreciation included in cost of sales) primarily consists of depreciation and amortization for buildings, store leasehold improvements, and equipment.

Store closure and other costs, net

Store closure and other costs, net primarily reflects costs incurred related to store closures, including impairment charges of long-lived assets, severance and any exit costs associated with closing a store. One-time disaster recovery and executive severance costs are also included here.

Factors Affecting Comparability of Results of Operations

COVID-19 Pandemic

Our results of operations for the year ended January 3, 2021 were impacted by increased demand from our customers initially stockpiling groceries and wellness products at the onset of the COVID-19 pandemic and continuing to consume more food at home throughout the year as restaurants have not fully reopened to pre-pandemic levels, and we in turn have made significant investments in compensation, benefits and personal protective equipment for our front-line store team members, as well as enhanced store sanitation procedures. We have also incurred increased ecommerce fees as consumers have increasingly used online shopping alternatives to purchase our products during the pandemic.

Additional Week in 2020

Fiscal 2020 consisted of 53 weeks. The 53rd week resulted in additional sales and expenses as further discussed in “—Comparison of Fiscal 2020 to Fiscal 2019” below.

March 2018 Refinancing

In March 2018, we completed a transaction in which we refinanced our debt (referred to as the “March 2018 Refinancing”), as further discussed in “—Liquidity and Capital Resources” below. The March 2018 Refinancing resulted in an increase in borrowing capacity, a reduction in interest rate and the recording of a loss on early extinguishment of debt (see Note 13, “Long-Term Debt and Finance Lease Liabilities”).

Results of Operations for Fiscal 2020, 2019 and 2018

The following tables set forth our results of operations and other operating data for the periods presented. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods. Fiscal 2020 consisted of 53 weeks, while each of Fiscal 2019 and Fiscal 2018 consisted of 52 weeks.

	Fiscal 2020	Fiscal 2019	Fiscal 2018
	(in thousands, except per share data)		
Consolidated Statement of Income Data:			
Net sales.....	\$ 6,468,759	\$ 5,634,835	\$ 5,207,336
Cost of sales.....	4,089,470	3,740,017	3,459,861
Gross profit.....	2,379,289	1,894,818	1,747,475
Selling, general and administrative expenses.....	1,863,869	1,549,707	1,404,443
Depreciation and amortization (exclusive of depreciation included in cost of sales).....	124,124	120,491	108,045
Store closure and other costs, net.....	(369)	7,260	12,076
Income from operations.....	391,665	217,360	222,911
Interest expense, net.....	14,787	21,192	27,435
Other income.....	—	—	320
Income before income taxes.....	376,878	196,168	195,796
Income tax provision.....	89,428	46,539	37,260
Net income.....	\$ 287,450	\$ 149,629	\$ 158,536
	Fiscal 2020	Fiscal 2019	Fiscal 2018
Other Operating Data:			
Comparable store sales growth.....	6.9%	1.1%	2.1%
Stores at beginning of period.....	340	313	285
Opened.....	22	28	30
Closed.....	—	(1)	(2)
Stores at end of period.....	362	340	313

Comparison of Fiscal 2020 to Fiscal 2019

Net sales

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Net sales	\$6,468,759	\$5,634,835	\$ 833,924	15%
Comparable store sales growth	6.9%	1.1%		

Net sales during 2020 totaled \$6.5 billion, increasing 15% over the prior fiscal year. Sales growth was primarily driven by strong performance in new stores opened in the last twelve months and a 6.9% increase in comparable store sales, each of which was largely driven by increased demand as a result of the COVID-19 pandemic, as well as the 53rd week in 2020. Comparable stores contributed approximately 92% of total sales for 2020 and approximately 91% for the prior fiscal year.

Cost of sales and gross profit

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Net sales	\$6,468,759	\$5,634,835	\$ 833,924	15%
Cost of sales	4,089,470	3,740,017	349,453	9%
Gross profit	2,379,289	1,894,818	484,471	26%
Gross margin	36.8%	33.6%	3.2%	

Gross profit increased during 2020 compared to 2019 by \$484.5 million to \$2.4 billion, primarily driven by increased sales volume. Gross margin increased by 3.2% to 36.8%, compared to 33.6%, due to strategic changes in promotional activities in addition to shrink favorability and positive leverage from the increase in sales driven by the COVID-19 pandemic. The impact of the 53rd week on gross margin was insignificant.

Selling, general and administrative expenses

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Selling, general and administrative expenses	\$1,863,869	\$1,549,707	\$ 314,162	20%
Percentage of net sales	28.8%	27.5%	1.3%	

Selling, general, and administrative expenses increased \$314.2 million or 20% as compared to 2019. As a percentage of net sales, selling, general and administrative expenses increased slightly by 1.3% due to higher bonus expense, ecommerce fees, and store operational expenses associated with COVID-19. The impact of the 53rd week on selling, general and administrative expenses was insignificant.

Depreciation and amortization

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Depreciation and amortization	\$ 124,124	\$ 120,491	\$ 3,633	3%
Percentage of net sales	1.9%	2.1%	(0.2)%	

Depreciation and amortization expenses (exclusive of depreciation included in cost of sales) increased \$3.6 million primarily related to new store growth as well as remodel initiatives in older stores. The impact of the 53rd week on depreciation and amortization was insignificant.

Store closure and other costs, net

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Store closure and other costs, net	\$ (369)	\$ 7,260	\$ (7,629)	(105)%
Percentage of net sales	—	0.1%	(0.1)%	

Store closure and other costs, net in 2020 primarily represented a recognized gain on the assignment of the lease for one of our closed locations in the first quarter of 2020, partially offset by ongoing activity associated with our closed store locations. In 2019, store closure and other costs, net of \$7.3 million includes \$4.1 million of impairment losses related to the write-down of leasehold improvements as well as one-time severance expense of \$1.2 million associated with the transition of our former President and Chief Operating Officer to Senior Advisor.

Interest expense, net

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Long-term debt	\$ 8,864	\$ 19,433	\$ (10,569)	(54)%
Capital and financing leases	970	997	(27)	(3)%
Deferred financing costs	575	564	11	2%
Interest rate hedge and other	4,378	198	4,180	2111%
Total interest expense, net	<u>\$ 14,787</u>	<u>\$ 21,192</u>	<u>\$ (6,405)</u>	<u>(30)%</u>

The decrease in interest expense, net was primarily due to the decrease in the average balance outstanding under the Amended and Restated Credit Agreement. This was partially offset by the interest expense paid as a result of an unfavorable interest rate swap. See Note 13, “Long-Term Debt and Finance Lease Liabilities” and Note 20, “Capital Stock.”

Income tax provision

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Income tax provision.....	\$ 89,428	\$ 46,539	42,889	92%
Effective tax rate.....	23.7%	23.7%	—	

Income tax provision increased by \$42.9 million to \$89.4 million for 2020 from \$46.5 million for 2019, primarily related to an increase in income before income taxes. The effective income tax rate was 23.7% in 2020 and 2019. The effective tax rate in 2020 was primarily affected by a decrease in federal tax credits and prior year release of uncertain tax positions, partially offset by the increase in charitable contribution deductions and the benefit recognized from amended returns.

Net income

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
		(dollars in thousands)		
Net income.....	\$ 287,450	\$ 149,629	\$ 137,821	92%
Percentage of net sales	4.4%	2.7%	1.7%	

Net income increased \$137.8 million primarily due to increased net sales and favorable margin impact related to COVID-19 and more balanced promotions, partially offset by higher selling, general and administrative expenses. Net income growth also included the benefit of the 53rd week in 2020.

Diluted earnings per share

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Change</u>	<u>% Change</u>
		(shares in thousands)		
Diluted earnings per share.....	\$ 2.43	\$ 1.25	\$ 1.18	95%
Diluted weighted average shares outstanding.....	118,224	119,742	(1,518)	

The increase in diluted earnings per share of \$1.18 was driven by higher net income.

Comparison of Fiscal 2019 to Fiscal 2018

Net sales

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
		(dollars in thousands)		
Net sales.....	\$5,634,835	\$5,207,336	\$ 427,499	8%
Comparable store sales growth	1.1%	2.1%		

Net sales during 2019 totaled \$5.6 billion, increasing 8% over the prior fiscal year. Sales growth was primarily driven by strong performance in new stores opened in the last twelve months. Comparable stores contributed approximately 91% of total sales for 2019 and approximately 89% for the prior fiscal year.

Cost of sales and gross profit

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
		(dollars in thousands)		
Net sales.....	\$5,634,835	\$5,207,336	\$ 427,499	8%
Cost of sales	3,740,017	3,459,861	280,156	8%
Gross profit	1,894,818	1,747,475	147,343	8%
Gross margin	33.6%	33.6%	—	

Gross profit increased during 2019 compared to 2018 by \$147.3 million, to \$1.9 billion, primarily driven by increased sales volume.

Selling, general and administrative expenses

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Selling, general and administrative expenses	\$ 1,549,707	\$ 1,404,443	\$ 145,264	10%
Percentage of net sales	27.5%	27.0%	0.5%	

Selling, general, and administrative expenses increased \$145.3 million or 10% as compared to 2018. This increase is primarily related to the 28 new stores that opened in 2019, as well as costs associated with a full year of operations for 2018 store openings. As a percentage of net sales, selling, general and administrative expenses increased slightly primarily due to higher occupancy costs related to the adoption of the new lease accounting standard that went into effect at the beginning of fiscal 2019 as well as higher costs associated with the expansion of our home delivery program, healthcare costs and credit card fees.

Depreciation and amortization

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Depreciation and amortization	\$ 120,491	\$ 108,045	\$ 12,446	12%
Percentage of net sales	2.1%	2.1%	—	

Depreciation and amortization expenses (exclusive of depreciation included in cost of sales) increased \$12.4 million primarily related to new store growth as well as remodel initiatives in older stores.

Store closure and other costs, net

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Store closure and other costs, net	\$ 7,260	\$ 12,076	\$ (4,816)	(40)%
Percentage of net sales	0.1%	0.2%	(0.1)%	

Store closure and other costs, net in 2019 of \$7.3 million includes \$4.1 million of impairment losses related to the write-down of leasehold improvements as well as one-time severance expense of \$1.2 million associated with the transition of our former President and Chief Operating Officer to Senior Advisor. In 2018, store closure and other costs, net included \$8.0 million primarily related to lease termination obligations and asset disposals associated with the closure of two underperforming stores during the fourth quarter of 2018, as well as one-time severance expense of \$3.6 million associated with the resignation of our former Chief Executive Officer.

Interest expense, net

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Long-term debt	\$ 19,433	\$ 14,920	\$ 4,513	30%
Capital and financing leases	997	11,855	(10,858)	(92)%
Deferred financing costs	564	799	(235)	(29)%
Interest rate hedge and other	198	(139)	337	(242)%
Total interest expense, net	<u>\$ 21,192</u>	<u>\$ 27,435</u>	<u>\$ (6,243)</u>	(23)%

The decrease in interest expense, net is due to the reclassification of previously reported financing leases to operating leases in connection with the adoption of the new lease accounting standard that went into effect at the beginning of 2019, partially offset by the higher average balance outstanding under the Amended and Restated Credit Agreement to fund our share repurchase program. See Note 13, “Long-Term Debt and Finance Lease Liabilities” and Note 20, “Capital Stock.”

Income tax provision

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Income tax provision.....	\$ 46,539	\$ 37,260	\$ 9,279	25%
Impact of Tax Act.....	—	2,573	(2,573)	(100)%
Income tax provision excluding impact of Tax Act	<u>\$ 46,539</u>	<u>\$ 39,833</u>	<u>\$ 6,706</u>	17%
Income tax rate	23.7%	19.0%	4.7%	

The effective tax rate increased to 23.7% in 2019 primarily due to the prior year excess tax benefits for the exercise of expiring pre-IPO options in the first half of fiscal year 2018.

Net income

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(dollars in thousands)			
Net income	\$ 149,629	\$ 158,536	\$ (8,907)	(6)%
Percentage of net sales.....	2.7%	3.0%	(0.3)%	

Net income decreased \$8.9 million primarily due to higher occupancy costs related to the adoption of the new lease standard that went into effect at the beginning of 2019, as well as cycling a lower effective tax rate in 2018.

Diluted earnings per share

	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>	<u>Change</u>	<u>% Change</u>
	(shares in thousands)			
Diluted earnings per share	\$ 1.25	\$ 1.22	\$ 0.03	2%
Diluted weighted average shares outstanding	119,742	129,776	(10,034)	

Earnings per share included a benefit of \$0.06 per share for 2019 and 2018, respectively, related 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 (“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 (“NOPAT”), including the effect of capitalized operating leases, divided by average invested capital. Operating lease interest represents the add-back to operating income driven by the hypothetical interest expense we would incur if the property under our operating leases were owned or accounted for as a finance lease (capital lease prior to adoption of ASC 842). The assumed ownership and associated interest expense are calculated using the discount rate for each lease as recorded as a component of rent expense within selling, general and administrative expenses. Invested capital reflects a trailing twelve-month average.

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

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

	<u>2020⁽¹⁾</u>	<u>2019</u>	<u>2018</u>
	(dollars in thousands)		
Net income.....	\$ 287,450	\$ 149,629	\$ 158,536
Income Tax Adjustment from Tax Act ⁽²⁾	—	—	(2,573)
Special items, net of tax ^{(3), (4)}	6,565	377	11,573
Interest expense, net of tax ⁽⁴⁾	11,272	16,214	22,178
Net operating profit after-tax (NOPAT)	<u>\$ 305,287</u>	<u>\$ 166,220</u>	<u>\$ 189,714</u>
Total rent expense, net of tax ⁽⁴⁾	146,630	129,748	111,401
Estimated depreciation on operating leases, net of tax ⁽⁴⁾	(80,944)	(61,898)	(49,016)
Estimated interest on operating leases, net of tax ^{(4), (5), (6)}	65,686	67,850	62,385
NOPAT, including effect of operating leases	<u>\$ 370,973</u>	<u>\$ 234,070</u>	<u>\$ 252,099</u>
Average working capital.....	101,622	37,505	26,877
Average property and equipment.....	735,651	737,851	754,380
Average other assets	567,188	567,554	574,968
Average other liabilities.....	(100,531)	(120,521)	(199,233)
Average invested capital	<u>\$1,303,930</u>	<u>\$1,222,389</u>	<u>\$1,156,992</u>
Average operating leases ⁽⁷⁾	<u>1,196,822</u>	<u>1,185,080</u>	<u>1,103,128</u>
Average invested capital, including operating leases	<u>\$2,500,752</u>	<u>\$2,407,469</u>	<u>\$2,260,120</u>
ROIC, including operating leases	<u>14.8%</u>	<u>9.7%</u>	<u>11.2%</u>

(1) Fiscal 2020 includes 53 weeks.

(2) \$2.6 million income tax benefit related to a tax calculation method change recognized in the third quarter of 2018; see Note 17, “Income Taxes.”

- (3) 2020 special items include professional fees related to our ongoing strategic initiatives. 2019 special items include the direct costs associated with store closure. 2018 special items include the direct costs associated with store closure and executive severance costs.
- (4) Net of tax amounts are calculated using the normalized effective tax rate for the periods presented.
- (5) 2020 and 2019 estimated interest on operating leases is calculated by multiplying operating leases by the 7.2% and 7.5% discount rate, respectively, for each lease recorded as rent expense within direct store expense.
- (6) 2018 estimated interest on capitalized operating leases is calculated as the trailing four quarters' rent expense multiplied by eight and by a 7.0% interest rate factor.
- (7) 2020 average operating leases represents the average net present value of outstanding lease obligations over the trailing four quarters. 2019 average operating leases represents the net present value of outstanding operating lease obligations. 2018 average operating leases is calculated as the trailing four quarters' rent expense multiplied by eight.

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):

	<u>Fiscal 2020</u>	<u>Fiscal 2019</u>	<u>Fiscal 2018</u>
Cash, cash equivalents and restricted cash at end of period.....	\$ 171,441	\$ 86,785	\$ 2,248
Cash from operating activities	\$ 494,035	\$ 355,210	\$ 294,379
Cash used in investing activities.....	\$ (121,968)	\$ (183,232)	\$ (177,082)
Cash used in financing activities	\$ (287,411)	\$ (87,441)	\$ (134,528)

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. Our future capital requirements will depend on many factors, including new store openings, remodel and maintenance capital expenditures at existing stores, store initiatives and other corporate capital expenditures and activities. Our cash, cash equivalents and restricted cash position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within days from the related sale.

Operating Activities

Cash flows from operating activities increased \$138.8 million to \$494.0 million in 2020 compared to \$355.2 million in 2019. The increase in cash flows from operating activities is primarily a result of cash generated from net income of \$287.5 million in 2020 compared to net income of \$149.6 million in 2019. Net income growth in 2020 is primarily due to increased net sales and favorable margin impact related to COVID-19, as well as the benefit of the 53rd week.

Cash flows from operating activities increased \$60.8 million to \$355.2 million in 2019 compared to \$294.4 million in 2018. The increase in cash flows from operating activities is primarily a result of changes in working capital.

Cash flows from/ (used in) operating activities from changes in working capital were \$83.4 million in 2020, compared to \$72.7 million in 2019 and (\$38.0) million in 2018. The increase in cash flows from operating activities for changes in working capital in 2020 compared to 2019 was primarily driven by elevated accounts payable and accrual balances in the current period.

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 \$122.0 million, \$183.2 million, and \$177.1 million for 2020, 2019, and 2018, respectively. The decrease in cash flows used in investing activities is primarily due to fewer stores under construction in 2020 as compared to 2019.

We expect capital expenditures to be in the range of \$140 - \$160 million in 2021, 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 and cash generated from operating activities.

Financing Activities

Cash flows used in financing activities were \$287.4 million for 2020 compared to \$87.4 million for 2019. During 2020, cash flows used in financing activities primarily consisted of \$288.0 million of payments on the Amended and Restated Credit Agreement.

During 2019, cash flows used in financing activities were \$87.4 million for 2019 compared to \$134.5 million for 2018. During 2019, cash flows used in financing activities primarily consisted of \$176.3 million for stock repurchases, partially offset by \$85.0 million of net borrowings on the Amended and Restated Credit Agreement and \$4.9 million from the exercise of stock options.

During 2018, cash flows used in financing activities consisted of \$258.3 million for stock repurchases, \$4.5 million cash paid for capital and financing lease obligations, partially offset by \$105 million of net borrowings on the Amended and Restated Credit Agreement, \$21.8 million in proceeds from the exercise of stock options and \$3.6 million from cash received from landlords related to finance lease obligations.

Long-term Debt and Credit Facilities

Long-term debt decreased \$288.0 million to \$250.0 million as of January 3, 2021 compared to December 29, 2019 due to payments on the Amended and Restated Credit Agreement.

Long-term debt increased \$85.0 million to \$538.0 million as of December 29, 2019 compared to December 30, 2018 due to net borrowings under our Amended and Restated Credit Agreement used to fund our share repurchase programs.

See Note 13, "Long-Term Debt and Finance Lease Liabilities" for a description of our Amended and Restated Credit Agreement and our Former Credit Facility (as defined therein).

Share Repurchase Program

On February 20, 2018, the Company's board of directors authorized a new \$350 million common stock share repurchase program, replacing the previous share repurchase program which was completed in the second quarter of 2018. Upon this authorization's December 31, 2019 expiration, \$42.0 million remained unused. Our board of directors has not authorized additional share repurchases subsequent to the expiration of the prior authorization on December 31, 2019, and there was no share repurchase authorization available as of January 3, 2021.

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 our company to acquire any particular amount of common stock, and the repurchase programs may be commenced, suspended, or discontinued at any time. We have used borrowings under our Former Credit Facility and Amended and Restated Credit Agreement to assist with the repurchase programs. See Note 13, "Long-Term Debt and Finance Lease Liabilities" of our audited consolidated financial statements, contained elsewhere in this Annual Report on Form 10-K, for more details.

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

	Year Ended	
	January 3, 2021	December 29, 2019
Number of common shares acquired.....	—	7,950,858
Average price per common share acquired.....	\$ —	\$ 22.18
Total cost of common shares acquired.....	\$ —	\$ 176,310

Shares purchased under our repurchase programs were subsequently retired.

Factors Affecting Liquidity

We can currently borrow under our Amended and Restated Credit Agreement, up to an initial aggregate commitment of \$700.0 million, which may be increased from time to time pursuant to an expansion feature set forth in the Amended and Restated Credit Agreement. We have previously utilized borrowings under our Amended and Restated Credit Agreement to fund our share repurchase program as described above. The interest rate we pay on our borrowings increases as our leverage ratio increases.

The Amended and Restated Credit Agreement contains financial, affirmative and negative covenants. The negative covenants include, among other things, limitations on our 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 our 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 we and our 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 April 1, 2018.

We were in compliance with all applicable covenants under the Amended and Restated Credit Agreement as of January 3, 2021.

Our Amended and Restated Credit Agreement is defined and more fully described in Note 13, “Long-Term Debt and Finance Lease Liabilities” of our audited consolidated financial statements contained elsewhere in this Annual Report on Form 10-K.

Contractual Obligations

The following table summarizes our contractual obligations as of January 3, 2021, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	(in thousands)				
Recorded contractual obligations:					
\$700.0 million Credit Agreement (1)	\$ 250,000	\$ —	\$250,000	\$ —	\$ —
Operating lease liabilities (2).....	1,720,857	195,910	370,643	346,992	807,312
Finance lease liabilities (2).....	17,018	1,591	3,227	3,638	8,562
Unrecorded contractual obligations:					
Interest payments on Credit Agreement (3).....	20,611	9,708	10,903	—	—
Real estate obligations (4)	182,953	3,366	22,253	23,592	133,742
Purchase commitments (5)	9,012	4,078	4,934	—	—
Totals (6)	<u>\$2,200,451</u>	<u>\$214,653</u>	<u>\$661,960</u>	<u>\$374,222</u>	<u>\$949,616</u>

- (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 “1-3 Years” column. See Note 13, “Long-Term Debt and Finance Lease Liabilities” to our unaudited consolidated financial statements located elsewhere in this Annual Report on Form 10-K.
- (2) Operating lease payments include \$184.8 million related to options to extend lease terms that are reasonably certain of being exercised. We have subtenant agreements under which we will receive \$1.6 million for the period of less than one year, \$2.6 million for years one to three, \$1.7 million for years four to five, and \$1.6 million for the period beyond five years.
- (3) 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 January 3, 2021 and based on LIBOR rates in effect at the time of this report, net of interest rate swaps.
- (4) Real estate obligations include legally binding minimum lease payments for leases executed but not yet commenced.
- (5) Consists primarily of purchase commitments under noncancelable service and supply contracts.
- (6) As of January 3, 2021, we had recorded \$48.5 million of liabilities related to our self-insurance programs. Self-insurance liabilities are not included in the table above because the payments are not contractual in nature and the timing of the payments is uncertain.

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

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

Off-Balance Sheet Arrangements

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

Impact of Deflation and Inflation

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

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

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, cash flow and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

We believe that of our significant accounting policies, which are described in Note 3, “Significant Accounting Policies” to the audited consolidated financial statements included in this Annual Report on Form 10-K, the following accounting policies involve a greater degree of judgment and complexity: inventory, lease assumptions, self-insurance reserves, goodwill and intangible assets, impairment of long-lived assets, fair values of share-based awards, and income taxes. Accordingly, we believe these are the most critical to fully understand and evaluate our financial condition and results of operations.

Inventories

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

Our non-perishable inventory is valued at the lower of cost or net realizable value using weighted averaging, the use of which approximates the FIFO method.

We believe that all inventories are saleable and no allowances or reserves for obsolescence were recorded as of January 3, 2021 and December 29, 2019.

Lease Assumptions

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

Expected lease term—Our expected lease term includes both contractual lease periods and option periods that are determined to be reasonably certain. The expected lease term is used in determining whether the lease is accounted for as an operating lease or a finance lease. An increase in the expected lease term will increase the probability that a lease will be considered a finance lease and will generally result in higher interest and depreciation expense for a leased property recorded on our balance sheets.

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

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

Self-Insurance Reserves

The Company is self-insured for costs related to workers' compensation, general liability and employee health benefits up to certain stop-loss limits. As of January 3, 2021, the consolidated self-insurance reserve balance was \$48.5 million, of which a majority of the balance related to workers' compensation and general liability reserves. Liabilities for self-insurance reserves are estimated based on independent actuarial estimates, which are based on historical information and assumptions about future events. We utilize various techniques, including analysis of historical trends and actuarial valuation methods, to estimate the cost to settle reported claims and claims incurred but not yet reported as of the balance sheet date. The actuarial valuation methods consider loss development factors, which include the development time frame and expected claim reporting and settlement patterns, and expected loss costs, which include the expected frequency and severity of claim activity. We believe our assumptions are reasonable, but the estimated reserves for these liabilities could be affected materially by future events or claims experiences that differ from historical trends and assumptions.

Goodwill and Intangible Assets

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

Goodwill and indefinite-lived intangible assets are evaluated for impairment on an annual basis during the fourth fiscal quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Our impairment evaluation of goodwill consists of a qualitative assessment to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If this qualitative assessment indicates it is more likely than not the estimated fair value of a reporting unit exceeds its carrying value, no further analysis is required and goodwill is not impaired. Our qualitative assessment considered factors including changes in the competitive market, budget-to-actual performance, trends in market capitalization for us and our peers, turnover in key management personnel and overall changes in macroeconomic environment.

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

No impairment of goodwill or indefinite-lived intangible assets was recorded during fiscal 2020, 2019 or 2018 because the fair value of those assets was substantially above carrying value.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. This evaluation is performed at the lowest level of identifiable cash flows independent of other assets. An impairment loss would be recognized when estimated undiscounted future cash flows from the operation and/or disposition of the assets are less than their carrying amount. Measurement of an impairment loss would be based on the excess of the carrying amount of the asset group over its fair value. Fair value is measured using discounted cash flows or independent opinions of value, as appropriate. No impairment was recorded during fiscal 2020. We recorded an impairment loss in 2019 during the normal course of business. We recorded an impairment loss during 2018, primarily related to asset write-offs in connection with the closure of two underperforming stores in the fourth quarter of 2018. See Note 3, "Significant Accounting Policies" and Note 6, "Property and Equipment".

Share-Based Compensation

Under the provisions of ASC 718, share-based compensation expense is measured at the grant date, based on the fair value of the award. Changes in these inputs and assumptions can materially affect the measurement of the estimated fair value of our share-based compensation expense.

We will continue to use judgment in evaluating the assumptions related to our share-based compensation on a prospective basis. If any of the assumptions used in the Black-Scholes model for options valuation change significantly, share-based compensation for future awards may differ materially compared with the awards granted previously. Refer to Note 26, "Share-Based Compensation" to our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K for further discussion of these assumptions.

Income Taxes

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

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

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

As described in Note 13, “Long-Term Debt and Finance Lease Liabilities” to our accompanying audited consolidated financial statements located elsewhere in this Annual Report on Form 10-K, we have an Amended and Restated Credit Agreement that bears interest at a rate based in part on LIBOR. Accordingly, we could be exposed to fluctuations in interest rates. Based solely on the \$250.0 million principal outstanding under our Amended and Restated Credit Agreement as of January 3, 2021, each hundred basis point change in LIBOR would result in a change in interest expense by \$2.5 million annually. We 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 two outstanding swaps at January 3, 2021 and the three outstanding swaps at December 29, 2019 was \$250.0 million, respectively, under which we pay a fixed rate and receive a variable rate of interest (cash flow swap). Taking into account the interest rate swaps, based on the \$250.0 million principal outstanding under our Amended and Restated Credit Agreement as of January 3, 2021, each hundred basis point change in LIBOR would result in no change in interest expense 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 22, “Derivative Financial Instruments”).

Item 8. *Financial Statements and Supplementary Data*

INDEX TO FINANCIAL STATEMENTS

Consolidated Financial Statements for

Sprouts Farmers Market, Inc. and Subsidiaries:

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Sprouts Farmers Market, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Sprouts Farmers Market, Inc. and its subsidiaries (the "Company") as of January 3, 2021 and December 29, 2019, and the related consolidated statements of income, of comprehensive income, of stockholders' equity and of cash flows for each of the three years in the period ended January 3, 2021, including the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of January 3, 2021, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of January 3, 2021 and December 29, 2019, and the results of its operations and its cash flows for each of the three years in the period ended January 3, 2021 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 3, 2021, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

Change in Accounting Principle

As discussed in Note 3 to the consolidated financial statements, the Company changed the manner in which it accounts for leases in 2019.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

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

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

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that (i) relates to accounts or disclosures that are material to the consolidated financial statements and (ii) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Valuation of Self-insurance Reserves

As described in Notes 3 and 15 to the consolidated financial statements, the Company is self-insured for costs related to workers' compensation, general liability and employee health benefits up to certain stop-loss limits. As of January 3, 2021, the Company's recorded amounts for general liability, workers' compensation and team member health benefit liabilities was \$48.5 million, with the most significant portion of the reserve balance related to workers' compensation and general liability self-insurance reserves. Management estimates the self-insurance reserves based on independent actuarial estimates, which are based on historical information and assumptions about future events. Management utilizes various techniques, including analysis of historical trends and actuarial valuation methods, to estimate the cost to settle reported claims and claims incurred but not yet reported as of the balance sheet date. When estimating the self-insurance reserves, several factors are considered by management, including (i) loss development factors, which include the development time frame and expected claim reporting and settlement patterns, and (ii) expected loss costs, which include the expected frequency and severity of claim activity.

The principal considerations for our determination that performing procedures relating to the valuation of self-insurance reserves is a critical audit matter are (i) the significant judgment by management when estimating the self-insurance reserves due to the use of various techniques to estimate the cost to settle reported claims and claims incurred but not yet reported; (ii) the high degree of auditor judgment, subjectivity and effort in performing procedures and evaluating audit evidence related to the loss development factors and expected loss costs; and (iii) the audit effort involved the use of professionals with specialized skill and knowledge.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to the valuation of self-insurance reserves, including controls over the historical information and assumptions about future events used in the actuarial valuation methods. These procedures also included, among others (i) evaluating management's self-insurance program agreements and (ii) testing the completeness and accuracy of the underlying historical claims data used in management's assessment. Professionals with specialized skill and knowledge were used to assist in testing management's process for estimating the valuation of the self-insurance reserves, including evaluating (i) the appropriateness of the actuarial valuation methods and (ii) the reasonableness of significant assumptions related to loss development factors and expected loss costs by considering (i) current and past claim and settlement activity and (ii) whether the assumptions were consistent with evidence obtained in other areas of the audit.

/s/ PricewaterhouseCoopers LLP

Phoenix, Arizona
February 25, 2021

We have served as the Company's auditor since 2011.

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	January 3, 2021	December 29, 2019
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 169,697	\$ 85,314
Accounts receivable, net.....	14,815	15,713
Inventories	254,224	275,979
Prepaid expenses and other current assets	27,224	10,833
Total current assets	465,960	387,839
Property and equipment, net of accumulated depreciation	726,500	741,508
Operating lease assets, net.....	1,045,408	1,028,436
Intangible assets, net of accumulated amortization.....	184,960	185,395
Goodwill	368,878	368,078
Other assets	14,698	11,727
Total assets	\$ 2,806,404	\$ 2,722,983
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 139,337	\$ 122,839
Accrued liabilities	143,402	136,482
Accrued salaries and benefits.....	76,695	48,579
Accrued income tax	—	2,005
Current portion of operating lease liabilities.....	135,739	106,153
Current portion of finance lease liabilities	959	754
Total current liabilities	496,132	416,812
Long-term operating lease liabilities	1,069,535	1,078,927
Long-term debt and finance lease liabilities	260,459	549,419
Other long-term liabilities	40,912	41,517
Deferred income tax liability.....	58,073	54,356
Total liabilities	1,925,111	2,141,031
Commitments and contingencies (Note 19)		
Stockholders' equity:		
Undesignated preferred stock; \$0.001 par value; 10,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 200,000,000 shares authorized, 117,953,435 shares issued and outstanding, January 3, 2021; 117,543,668 shares issued and outstanding, December 29, 2019	118	117
Additional paid-in capital.....	686,648	670,966
Accumulated other comprehensive loss	(8,474)	(4,682)
Retained earnings (Accumulated deficit).....	203,001	(84,449)
Total stockholders' equity	881,293	581,952
Total liabilities and stockholders' equity	\$ 2,806,404	\$ 2,722,983

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

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

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Net sales	\$6,468,759	\$ 5,634,835	\$ 5,207,336
Cost of sales	4,089,470	3,740,017	3,459,861
Gross profit.....	2,379,289	1,894,818	1,747,475
Selling, general and administrative expenses.....	1,863,869	1,549,707	1,404,443
Depreciation and amortization (exclusive of depreciation included in cost of sales).....	124,124	120,491	108,045
Store closure and other costs, net	(369)	7,260	12,076
Income from operations.....	391,665	217,360	222,911
Interest expense, net.....	14,787	21,192	27,435
Other income.....	—	—	320
Income before income taxes	376,878	196,168	195,796
Income tax provision	89,428	46,539	37,260
Net income	<u>\$ 287,450</u>	<u>\$ 149,629</u>	<u>\$ 158,536</u>
Net income per share:			
Basic.....	\$ 2.44	\$ 1.25	\$ 1.23
Diluted	\$ 2.43	\$ 1.25	\$ 1.22
Weighted average shares outstanding:			
Basic.....	<u>117,821</u>	<u>119,368</u>	<u>128,827</u>
Diluted	<u>118,224</u>	<u>119,742</u>	<u>129,776</u>

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

SPROUTS FARMERS MARKET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(IN THOUSANDS)

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Net income	\$ 287,450	\$ 149,629	\$ 158,536
Other comprehensive income (loss), net of tax			
Unrealized gains (losses) on cash flow hedging activities, net of income tax of (\$205), (\$2,078), and \$561.....	(592)	(6,006)	1,624
Reclassification of net gains (losses) on cash flow hedges to net income, net of income tax of (\$1,107), \$66, and \$102	(3,200)	190	294
Total other comprehensive income (loss).....	<u>\$ (3,792)</u>	<u>\$ (5,816)</u>	<u>\$ 1,918</u>
Comprehensive income	<u>\$ 283,658</u>	<u>\$ 143,813</u>	<u>\$ 160,454</u>

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

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

	Shares	Common Stock	Additional Paid-in Capital	(Accumulated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances at December 31, 2017	132,450,092	\$ 132	\$ 620,788	\$ 30,558	\$ (784)	\$ 650,694
Net income	—	—	—	158,536	—	158,536
Other comprehensive income (loss)	—	—	—	—	1,918	1,918
Issuance of shares under stock plans	3,227,693	3	21,840	—	—	21,843
Repurchase and retirement of common stock	(11,096,595)	(11)	—	(258,296)	—	(258,307)
Share-based compensation	—	—	14,512	—	—	14,512
Balances at December 30, 2018	124,581,190	\$ 124	\$ 657,140	\$ (69,202)	\$ 1,134	\$ 589,196
Net income	—	—	—	149,629	—	149,629
Other comprehensive income (loss)	—	—	—	—	(5,816)	(5,816)
Issuance of shares under stock plans	822,586	1	4,877	—	—	4,878
Repurchase and retirement of common stock	(7,950,858)	(8)	—	(176,302)	—	(176,310)
Share-based compensation	—	—	8,949	—	—	8,949
Impact of adoption of ASC 842 related to leases	—	—	—	11,426	—	11,426
Balances at December 29, 2019	117,452,918	\$ 117	\$ 670,966	\$ (84,449)	\$ (4,682)	\$ 581,952
Net income	—	—	—	287,450	—	287,450
Other comprehensive income (loss)	—	—	—	—	(3,792)	(3,792)
Issuance of shares under stock plans	500,517	1	1,343	—	—	1,344
Share-based compensation	—	—	14,339	—	—	14,339
Balances at January 3, 2021	117,953,435	\$ 118	\$ 686,648	\$ 203,001	\$ (8,474)	\$ 881,293

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

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

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Cash flows from operating activities			
Net income	\$ 287,450	\$ 149,629	\$ 158,536
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	126,507	122,804	110,749
Operating lease asset amortization	99,276	81,842	—
Store closure and other costs, net	(321)	4,113	4,115
Share-based compensation	14,339	8,949	14,512
Deferred income taxes	3,717	(216)	23,333
Other non-cash items	3,683	4,136	1,482
Changes in operating assets and liabilities:			
Accounts receivable	25,977	36,062	(7,666)
Inventories	21,754	(11,612)	(34,824)
Prepaid expenses and other current assets	(14,970)	19,208	(2,908)
Other assets	(5,461)	(1,275)	(5,086)
Accounts payable	20,184	9,420	12,238
Accrued liabilities	4,296	17,274	(4,481)
Accrued salaries and benefits	28,116	295	3,039
Accrued income tax	(2,005)	2,005	(3,391)
Operating lease liabilities	(120,085)	(88,002)	—
Other long-term liabilities	1,578	578	24,731
Cash flows from operating activities	<u>494,035</u>	<u>355,210</u>	<u>294,379</u>
Cash flows from investing activities			
Purchases of property and equipment	(121,968)	(183,232)	(177,082)
Cash flows used in investing activities	<u>(121,968)</u>	<u>(183,232)</u>	<u>(177,082)</u>
Cash flows from financing activities			
Proceeds from revolving credit facilities	—	265,405	233,000
Payments on revolving credit facilities	(288,000)	(180,405)	(128,000)
Payments on capital and financing lease obligations	—	—	(4,517)
Payments on finance lease liabilities	(754)	(690)	—
Payments of deferred financing costs	—	—	(2,131)
Cash from landlord related to capital and financing lease obligations	—	—	3,643
Repurchase of common stock	—	(176,310)	(258,307)
Proceeds from exercise of stock options	1,343	4,878	21,843
Other	—	(319)	(59)
Cash flows used in financing activities	<u>(287,411)</u>	<u>(87,441)</u>	<u>(134,528)</u>
Increase / (Decrease) in cash, cash equivalents, and restricted cash	84,656	84,537	(17,231)
Cash, cash equivalents, and restricted cash at beginning of the period	86,785	2,248	19,479
Cash, cash equivalents, and restricted cash at the end of the period	<u>\$ 171,441</u>	<u>\$ 86,785</u>	<u>\$ 2,248</u>
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ 14,786	\$ 20,293	\$ 27,086
Cash paid for income taxes	94,767	44,637	15,527
Leased assets obtained in exchange for new operating lease liabilities	118,075	160,134	—
Supplemental disclosure of non-cash investing and financing activities			
Property and equipment in accounts payable	\$ 10,869	\$ 18,515	\$ 12,001
Property acquired through capital and financing lease obligations	—	—	9,081

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

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

1. Organization and Description of Business

Sprouts Farmers Market, Inc., a Delaware corporation, through its subsidiaries, offers a unique grocery experience featuring an open layout with fresh produce at the heart of the store. The Company continues to bring the latest in wholesome, innovative products made with lifestyle-friendly ingredients such as organic, plant-based and gluten-free. As of January 3, 2021, the Company operated 362 stores in 23 states. For convenience, the “Company” is used to refer collectively to Sprouts Farmers Market, Inc. and, unless the context requires otherwise, its subsidiaries. The Company’s store operations are conducted by its subsidiaries.

2. Basis of Presentation

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

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

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.

The following is a breakdown of the Company’s perishable and non-perishable sales mix:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Perishables.....	57.2%	57.7%	57.5%
Non-Perishables.....	42.8%	42.3%	42.5%

All dollar amounts are in thousands, unless otherwise indicated. Certain prior period amounts have been reclassified to conform with the current year presentation.

3. Significant Accounting Policies

Fiscal Years

The Company reports its results of operations on a 52- or 53-week fiscal calendar ending on the Sunday closest to December 31. Fiscal year 2020 ended on January 3, 2021 and included 53-weeks. Fiscal year 2019 ended on December 29, 2019 and included 52-weeks. Fiscal year 2018 ended on December 30, 2018 and included 52-weeks. Fiscal years 2020, 2019, and 2018 are referred to as 2020, 2019, and 2018, respectively.

Significant Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. Such estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company’s critical accounting estimates include inventory valuations, lease assumptions, self-insurance reserves, impairment of long-lived assets, fair values of share-based awards, and income taxes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents. The Company's cash and cash equivalents are maintained at financial institutions in the United States of America. Deposits in transit include sales through the end of the period, the majority of which were paid with credit and debit cards and settle within a few days of the sales transactions. The amounts due from banks for these transactions at each reporting date were as follows:

	As Of	
	January 3, 2021	December 29, 2019
Due from banks for debit and credit card transactions	\$ 93,130	\$ 49,405

Restricted Cash

Restricted cash relates to the Company's defined benefit plan forfeitures and the Company's healthcare, general liability and workers' compensation plan benefits of approximately \$1.7 million and \$1.5 million as of January 3, 2021 and December 29, 2019, respectively, and is included in prepaid expenses and other current assets in the accompanying consolidated balance sheets.

Accounts Receivable

Accounts receivable primarily represents billings to vendors for scan, advertising and other rebates, and billings to landlords for tenant allowances. Accounts receivable also includes receivables from the Company's insurance carrier for payments expected to be made in excess of self-insured retentions. The Company provides an allowance for doubtful accounts when a specific account is determined to be uncollectible.

Inventories

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

The Company's non-perishable inventory is valued at the lower of cost or net realizable value using weighted averaging, the use of which approximates the FIFO method.

The Company believes that all inventories are saleable and no allowances or reserves for obsolescence were recorded as of January 3, 2021 and December 29, 2019.

Property and Equipment

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

The following table includes the estimated useful lives of certain of the Company's asset classes:

Computer hardware and software.....	3 to 5 years
Furniture, fixtures and equipment	7 to 20 years
Leasehold improvements	up to 15 years
Buildings.....	40 years

Store development costs, which include costs associated with the selection and procurement of real estate sites, are also included in property and equipment. These costs are included in leasehold improvements and are amortized over the remaining lease term of the successful sites with which they are associated.

Self-Insurance Reserves

The Company uses a combination of insurance and self-insurance programs to provide for costs associated with general liability, workers' compensation and team member health benefits. Liabilities for self-insurance reserves are estimated based on independent actuarial estimates, which are based on historical information and assumptions about future events. The Company utilizes various techniques, including analysis of historical trends and actuarial valuation methods, to estimate the cost to settle reported claims and claims incurred but not yet reported as of the balance sheet date. The actuarial valuation methods consider loss development factors, which include the development time frame and expected claim reporting and settlement patterns, and expected loss costs, which include the expected frequency and severity of claim activity. Amounts expected to be recovered from insurance companies are included in the liability, with a corresponding amount recorded in accounts receivable.

Goodwill and Intangible Assets

Goodwill represents the cost of acquired businesses in excess of the fair value of assets and liabilities acquired. The Company's indefinite-lived intangible assets consist of trade names related to "Sprouts Farmers Market" and liquor licenses. The Company also holds intangible assets with finite useful lives consisting of the "Sunflower Farmers Market" trade name. The trade name related to "Sunflower Farmers Market" meets the definition of a defensive intangible asset and was amortized on a straight-line basis over an estimated useful life of 10 years from the date of its acquisition by the Company.

Goodwill and indefinite-lived intangible assets are evaluated for impairment on an annual basis during the fourth fiscal quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company's impairment evaluation of goodwill consists of a qualitative assessment to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The Company's qualitative assessment considered factors including changes in the competitive market, budget-to-actual performance, trends in market capitalization for the Company and its peers, turnover in key management personnel and overall changes in macroeconomic environment. If this qualitative assessment indicates it is more likely than not that the estimated fair value of a reporting unit exceeds its carrying value, no further analysis is required and goodwill is not impaired. Otherwise, we compare the estimated fair value of the asset to its carrying amount with an impairment loss recognized for the amount, if any, by which carrying value exceeds estimated fair value.

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

The Company has determined its business consists of a single reporting unit, healthy grocery stores. The Company has had no goodwill impairment charges for the past three fiscal years. See Note 8, "Intangible Assets" and Note 9, "Goodwill" for further discussion.

Impairment of Long-Lived Assets

The Company assesses its long-lived assets, including property and equipment, right-of-use assets and finite-lived intangible assets, for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. These events primarily include current period losses combined with a history of losses or a projection of continuing losses, a significant decrease in the market value of an asset or a decision to close or relocate a store. The Company groups and evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which independent identifiable cash flows are available. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset group to the future undiscounted cash flows expected to be generated by that asset group. The Company's impairment analysis contains management assumptions about key variables including sales growth rate, gross margin, payroll and other controllable expenses.

If impairment is indicated, a loss is recognized for any excess of the carrying value over the estimated fair value of the asset group. The fair value of the asset group is estimated based on the discounted future cash flows using a discount rate commensurate with the related risk or comparable market values, if available. There were no impairment charges in 2020. In 2019, the Company recorded an impairment loss as part of the normal course of business primarily related to the write-down of leasehold improvements. In fiscal year 2018, the Company recorded an impairment loss related to leasehold improvements, furniture, fixtures and equipment due to the closure of two stores. These charges are recorded as a component of Store closure and other costs, net in the accompanying consolidated statement of income.

Deferred Financing Costs

The Company capitalizes certain fees and costs incurred in connection with the issuance of debt. Deferred financing costs are amortized to interest expense over the term of the debt using the effective interest method. For the Amended and Restated Credit Agreement and Former Credit Facility (as defined in Note 13, "Long-Term Debt and Finance Lease Liabilities"), deferred financing costs are amortized on a straight-line basis over the term of the facility. Upon prepayment, redemption or conversion of debt, the Company accelerates the recognition of an appropriate amount of financing costs as loss on extinguishment of debt. The current and noncurrent portions of deferred financing costs are included in prepaid expenses and other current assets and other assets, respectively, in the accompanying consolidated balance sheets.

Leases

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

The Company's lease assets represent a right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Lease assets and liabilities and the related rent expense are recognized at the lease commencement date (date

on which the Company gains access to the property) based on the estimated present value of lease payments over the lease term, net of landlord allowances expected to be received. The Company accounts for the lease and non-lease components as a single lease component for all current classes of leases.

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

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

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

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

Fair Value Measurements

The Company records its financial assets and liabilities in accordance with the framework for measuring fair value in accordance with ASC 820. This framework establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value:

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

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

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

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in the valuation of derivative instruments, impairment analysis of goodwill, intangible assets, and long-lived assets. Impairment losses related to store-level assets are calculated using significant unobservable inputs including the present value of future cash flows expected to be generated using a risk-adjusted market based weighted-average cost of capital, comparable store sales growth assumptions, and third party property appraisal data. Therefore, these inputs are classified as a level 3 measurement in the fair value hierarchy.

Cash, cash equivalents and restricted cash, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued salaries and benefits and other accrued liabilities approximate fair value because of the short maturity of those instruments.

Derivative Financial Instruments

The Company records derivatives at fair value. The designation of a derivative instrument as a hedge and its ability to meet the hedge accounting criteria determine how the Company reflects the change in fair value of the derivative instrument in its financial statements. A derivative qualifies for hedge accounting if, at inception, the derivative is expected to be highly effective in offsetting the underlying

hedged cash flows, and the Company fulfills the hedge documentation standards at the time it enters into the derivative contract. The Company designates its hedge based on the exposure it is hedging. For qualifying cash flow hedges, the Company records changes in fair value in other comprehensive income ("OCI"). The Company releases the derivative's gain or loss from OCI to match the timing of the underlying hedged item's effect on earnings.

The Company reviews the effectiveness of its hedging instruments quarterly. The Company recognizes changes in the fair value for derivatives not designated as hedges or those not qualifying for hedge accounting in current period earnings. The Company discontinues hedge accounting for any hedge that is no longer evaluated to be highly effective.

The Company does not enter into derivative financial instruments for trading or speculative purposes, and it monitors the financial stability and credit standing of its counterparties in these transactions.

Share-Based Compensation

The Company measures share-based compensation cost at the grant date based on the fair value of the award and recognizes share-based compensation cost as expense over the vesting period. As share-based compensation expense recognized in the consolidated statements of income is based on awards ultimately expected to vest, the amount of expense has been reduced for actual forfeitures as they occur. The Company uses the Black-Scholes option-pricing model to determine the grant date fair value for each option grant. The Black-Scholes option-pricing model requires extensive use of subjective assumptions. See Note 26, "Share-Based Compensation" for a discussion of assumptions used in the calculation of fair values. Application of alternative assumptions could produce different estimates of the fair value of share-based compensation and, consequently, the related amounts recognized in the accompanying consolidated statements of income. The grant date fair value of restricted stock units ("RSUs"), performance share awards ("PSAs"), and restricted stock awards ("RSAs") is based on the closing price per share of the Company's stock on the grant date. The Company recognizes compensation expense for time-based awards on a straight-line basis and for performance-based awards on the graded-vesting method over the vesting period of the awards.

Revenue Recognition

The Company's performance obligations are satisfied upon the transfer of goods to the customer, which occurs 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 Company's gift cards do not expire. Based on historical redemption rates, a small and relatively stable percentage of gift cards will never be redeemed, referred to as "breakage." Estimated breakage revenue is recognized over time in proportion to actual gift card redemptions and was not material in any period presented.

	Balance as of December 29, 2019	Gift Cards Issued During Current Period But Not Redeemed ^(a)	Revenue Recognized From Beginning Liability	Balance as of January 3, 2021
Gift card liability, net	\$ 15,902	\$ 9,895	\$ (9,909)	\$ 15,888
(a) net of estimated breakage				

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

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 January 3, 2021.

Cost of Sales

Cost of sales includes the cost of inventory sold during the period, including the direct costs of purchased merchandise (net of discounts and allowances), distribution and supply chain costs, supplies and depreciation and amortization for distribution centers and supply chain related assets. The Company recognizes vendor allowances and merchandise volume related rebate allowances as a reduction of inventories during the period when earned and reflects the allowances as a component of cost of sales as the inventory is sold.

The Company's largest supplier accounted for approximately 42%, 40% and 34% of total purchases during 2020, 2019, and 2018, respectively.

Selling, General and Administrative Expenses

Selling, general and administrative expenses primarily consist of salaries, wages and benefits costs, share-based compensation, occupancy costs (including rent, property taxes, utilities, common area maintenance and insurance), advertising costs, buying cost, pre-opening and other administrative costs.

The Company charges certain vendors to place advertisements in the Company's in-store guide and circulars under a cooperative advertising program. The Company records rebates received from vendors in connection with cooperative advertising programs as a reduction to advertising costs when the allowance represents a reimbursement of a specific incremental and identifiable cost. Advertising costs are expensed as incurred. Advertising expense, net of rebates, was \$54.4 million, \$57.2 million and \$50.2 million for 2020, 2019, and 2018, respectively.

Depreciation and amortization

Depreciation and amortization expense (exclusive of depreciation included in cost of sales) primarily consists of depreciation and amortization for buildings, store leasehold improvements, and equipment.

Income Taxes

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

The Company files income tax returns for federal purposes and in many states. The Company's tax filings remain subject to examination by applicable tax authorities for a certain length of time, generally three years, following the tax year to which those filings relate. The Company's U.S. federal income tax return for the fiscal year ended December 31, 2017, is currently under examination by the Internal Revenue Service.

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

Share Repurchases

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

Net Income per Share

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

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

Comprehensive Income

Comprehensive income consists of net income and the unrealized gains or losses on derivative instruments that qualify for and have been designated as cash flow hedges, for all periods presented.

Recently Adopted Accounting Pronouncements

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU no. 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this update introduce a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Subsequent to the initial standards, the FASB has also issued several ASUs to clarify specific topics. The Company adopted ASU 2016-13 effective December 30, 2019, using the modified retrospective approach. There was no impact to opening retained earnings as of December 30, 2019 or on the Company’s consolidated financial statements.

Compensation – Fair Value Disclosures

In August 2018, the FASB issued ASU No. 2018-13, “Fair value measurement (Topic 820) – Disclosure framework – Changes to the disclosure requirements for fair value measurement.” The amendments in this update improve the effectiveness of fair value measurement disclosures. The Company adopted this standard effective December 30, 2019. There was no impact on the Company’s disclosure in its consolidated financial statements.

Leases

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.

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

The adoption of the standard resulted in the recognition of operating lease assets and liabilities of approximately \$1.0 billion and \$1.1 billion, respectively, as of December 31, 2018, including recognition of operating lease assets and liabilities for certain third-party operated distribution center locations. Included

in the measurement of the new lease assets and liabilities is the reclassification of balances historically recorded as deferred rent and unfavorable and favorable leasehold interests. Additionally, the Company recognized a cumulative effect adjustment, which increased retained earnings by \$11.4 million, net of tax. This adjustment was driven by the derecognition of approximately \$114.0 million of lease obligations and \$102.6 million of net assets related to leases that had been classified as financing lease obligations under the former failed-sale leaseback guidance, and are now classified as operating leases as of the transition date.

This reclassification also resulted in the recognition of rent expense beginning December 31, 2018, which was previously reported as interest expense under the former failed sale-leaseback guidance. Lastly, the adoption of this standard resulted in a change in naming convention for leases classified historically as capital leases. These leases are now referred to as finance leases. The adoption of this standard did not have any impact on the Company's liquidity or cash flows.

Refer to Note 7, "Leases", for additional information related to the Company's leases.

Recently Issued Accounting Pronouncements Not Yet Adopted

Income Taxes –Accounting for Income Taxes

In December 2019, the FASB issued ASU no. 2019-12, "Income Taxes (Topic 740) Simplifying the Accounting for Income Taxes." Among other things, the amendment removes certain exceptions for periods with operating losses, and reduces the complexity surrounding franchise tax, step up in tax basis of goodwill in conjunction with a business combination, and timing of enacting changes in tax laws during interim periods. The amendments in this update are effective for the Company for its fiscal year 2021 with early adoption permitted. The Company does not expect this update to have a material effect on the Company's consolidated financial statements.

Reference Rate Reform

In March 2020, the FASB issued ASU no. 2020-04, "Reference rate reform (Topic 848) – Facilitation of the effects of reference rate reform on financial reporting". The amendments in this update provide optional expedients and exceptions for a limited period of time to ease the potential burden in accounting for contracts, hedging relationships, and other transactions affected by reference rate reform. Generally, the guidance allows contract modifications related to reference rate reform to be considered events that do not require remeasurements or reassessments of previous accounting determinations at the modification date. This update only applies to modifications made prior to December 31, 2022. No such modifications occurred in the year ending January 3, 2021. The Company expects to utilize this optional guidance but does not expect it to have a material impact on its consolidated financial statements.

No other new accounting pronouncements issued or effective during fiscal 2020 had, or are expected to have, a material impact on the Company's consolidated financial statements.

4. Accounts Receivable

A summary of accounts receivable is as follows:

	As Of	
	January 3, 2021	December 29, 2019
Landlords	\$ 4,715	\$ 7,565
Vendors	3,275	5,378
Insurance	1,279	938
Supply rebates	—	749
Other	5,546	1,083
Total	<u>\$ 14,815</u>	<u>\$ 15,713</u>

The Company recorded allowances for certain vendor receivables of \$0.4 million and \$0.5 million at January 3, 2021 and December 29, 2019, respectively.

5. Prepaid Expenses and Other Current Assets

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

	As Of	
	January 3, 2021	December 29, 2019
Prepaid expenses	\$ 15,948	\$ 8,784
Restricted cash	1,744	1,470
Prepaid rent	141	15
Income tax receivable	8,827	—
Other current assets	564	564
Total	<u>\$ 27,224</u>	<u>\$ 10,833</u>

6. Property and Equipment

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

	As Of	
	January 3, 2021	December 29, 2019
Land and finance lease assets	\$ 15,753	\$ 15,753
Furniture, fixtures and equipment	745,514	666,050
Leasehold improvements	638,149	589,211
Construction in progress	27,140	48,311
Total property and equipment	1,426,556	1,319,325
Accumulated depreciation and amortization	(700,056)	(577,817)
Property and equipment, net	<u>\$ 726,500</u>	<u>\$ 741,508</u>

Depreciation expense was \$125.6 million, \$121.3 million and \$110.3 million for 2020, 2019, and 2018, respectively. Depreciation expense is primarily reflected in depreciation and amortization on the consolidated statements of income.

There was no impairment expense recognized in 2020. Impairment expense was \$4.1 million and \$4.6 million for 2019 and 2018, respectively.

7. Leases

Lease cost includes both the fixed and variable expenses recorded for leases. The components of lease cost are as follows:

	Classification	Year Ended January 3, 2021	Year Ended December 29, 2019
Operating lease cost	Selling, general and administrative expenses ^{(1), (2)}	\$ 191,279	\$ 177,089
Finance lease cost:			
Amortization of Property and Equipment	Depreciation and amortization	966	966
Interest on lease liabilities	Interest expense	970	997
Variable lease cost	Selling, general and administrative expenses ⁽¹⁾	57,789	53,731
Sublease income	Selling, general and administrative expenses	(1,192)	(1,057)
Total net lease cost		<u>\$ 249,812</u>	<u>\$ 231,726</u>

(1) Supply chain-related amounts of \$7.8 million and \$8.2 million were included in cost of sales for 2020 and 2019, respectively.

(2) Rent expense in fiscal year 2018 totaled \$137.5 million under ASC 840.

Supplemental balance sheet information related to leases is as follows:

	Classification	As of January 3, 2021	As of December 29, 2019
Assets			
Operating	Operating lease assets	\$ 1,045,408	\$ 1,028,436
Finance	Property and equipment, net	9,218	10,184
Total lease assets		<u>\$ 1,054,626</u>	<u>\$ 1,038,620</u>
Liabilities			
Current			
Operating	Current portion of operating lease liabilities	\$ 135,739	\$ 106,153
Finance	Current portion of finance lease liabilities	959	754
Noncurrent			
Operating	Long-term operating lease liabilities	1,069,535	1,078,927
Finance	Long-term debt and finance lease liabilities	10,459	11,419
Total lease liabilities		<u>\$ 1,216,692</u>	<u>\$ 1,197,253</u>

	January 3, 2021	December 29, 2019
Weighted average remaining lease term (years)		
Operating leases	9.8	10.2
Finance leases	9.7	10.7
Weighted average discount rate		
Operating leases	7.2%	7.5%
Finance leases	8.4%	8.3%

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

	Year Ended January 3, 2021	Year Ended December 29, 2019
Cash paid for amounts included in measurement of lease liabilities:		
Operating cash flows for operating leases.....	\$ 186,280	\$ 153,292
Operating cash flows for finance leases	970	997
Lease assets obtained in exchange for lease liabilities:		
Finance leases.....	\$ —	\$ —
Operating leases.....	118,075	160,134

A summary of maturities of lease liabilities is as follows:

	Operating Leases ⁽¹⁾	Finance Leases	Total
2021	\$ 195,910	\$ 1,591	\$ 197,501
2022	197,145	1,671	198,816
2023	173,498	1,556	175,054
2024	175,700	1,734	177,434
2025	171,292	1,904	173,196
Thereafter.....	807,312	8,562	815,874
Total lease payments	1,720,857	17,018	1,737,875
Less: Imputed interest.....	(515,583)	(5,600)	(521,183)
Total lease liabilities	1,205,274	11,418	1,216,692
Less: Current portion.....	(135,739)	(959)	(136,698)
Long-term lease liabilities.....	<u>\$ 1,069,535</u>	<u>\$ 10,459</u>	<u>\$ 1,079,994</u>

- (1) Operating lease payments include \$184.8 million related to options to extend lease terms that are reasonably certain of being exercised and exclude \$183.0 million of legally binding minimum lease payments for leases executed but not yet commenced.

8. Intangible Assets

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

	Balance at December 30, 2018	Adjustments/ Transfers ⁽¹⁾	Balance at December 29, 2019
Gross Intangible Assets			
Indefinite-lived trade names	\$ 182,937	\$ —	\$ 182,937
Indefinite-lived liquor licenses.....	2,023	—	2,023
Finite-lived trade names	1,800	—	1,800
Leasehold interests	18,773	(18,773)	—
Total intangible assets.....	<u>\$ 205,533</u>	<u>\$ (18,773)</u>	<u>\$ 186,760</u>
Accumulated Amortization			
Finite-lived trade names	\$ (1,185)	\$ (180)	\$ (1,365)
Leasehold interests	(9,545)	9,545	—
Total accumulated amortization.....	<u>\$ (10,730)</u>	<u>\$ 9,365</u>	<u>\$ (1,365)</u>

- (1) As of the first day of fiscal 2019, the favorable leasehold interest balance was reclassified into the new operating lease asset balance due to the adoption of ASC 842. As a result, the amortization of these assets is recorded as part of the single rent expense to be recorded on a monthly basis for each lease. Refer to Note 7, "Leases", for further details.

	Balance at December 29, 2019	Adjustments/ Transfers	Balance at January 3, 2021
Gross Intangible Assets			
Indefinite-lived trade names	\$ 182,937	\$ —	\$ 182,937
Indefinite-lived liquor licenses	2,023	—	2,023
Finite-lived trade names	1,800	(800)	1,000
Total intangible assets.....	<u>\$ 186,760</u>	<u>\$ (800)</u>	<u>\$ 185,960</u>
Accumulated Amortization			
Finite-lived trade names	\$ (1,365)	\$ 365	\$ (1,000)
Total accumulated amortization.....	<u>\$ (1,365)</u>	<u>\$ 365</u>	<u>\$ (1,000)</u>

Amortization expense was (\$0.4) million, \$0.2 million and \$1.4 million for 2020, 2019, and 2018, respectively.

9. Goodwill

The Company's goodwill balance was \$368.9 million and \$368.1 million as of January 3, 2021 and December 29, 2019, respectively. As of January 3, 2021 and December 29, 2019, the Company had no accumulated goodwill impairment losses. The goodwill was related to the acquisition of Sunflower Farmers Market stores and Henry's Farmers Market stores.

A summary of the activity and balance in goodwill is as follows:

	Balance at December 29, 2019	Adjustments	Balance at January 3, 2021
Goodwill	\$ 368,078	\$ 800	\$ 368,878

10. Other Assets

As of January 3, 2021 and December 29, 2019, other assets of \$14.7 and \$11.7 million, respectively, primarily consisted of deferred software as a service, capitalized durable supplies, sublease deferred rent, and miscellaneous other assets.

11. Accrued Liabilities

A summary of accrued liabilities is as follows:

	As Of	
	January 3, 2021	December 29, 2019
Self-insurance reserves	\$ 25,227	\$ 22,806
Accrued occupancy related (CAM, property taxes, etc.)	19,939	16,211
Gift cards, net of breakage	15,888	15,902
Accrued sales and use tax.....	14,712	12,010
Other accrued liabilities	67,636	69,553
Total	<u>\$ 143,402</u>	<u>\$ 136,482</u>

12. Accrued Salaries and Benefits

A summary of accrued salaries and benefits is as follows:

	As Of	
	January 3, 2021	December 29, 2019
Bonuses	\$ 41,637	\$ 16,800
Payroll	18,171	15,667
Vacation	14,669	11,880
Severance and other	2,218	4,232
Total	<u>\$ 76,695</u>	<u>\$ 48,579</u>

13. Long-Term Debt and Finance Lease Liabilities

A summary of long-term debt is as follows:

Facility	Maturity	Interest Rate	As Of	
			January 3, 2021	December 29, 2019
Senior secured debt				
\$700.0 million Credit Agreement	March 27, 2023	Variable	\$ 250,000	\$ 538,000
Finance lease liabilities (see Note 7, "Leases")	Various	n/a	<u>10,459</u>	<u>11,419</u>
Long-term debt and finance lease liabilities			<u>\$ 260,459</u>	<u>\$ 549,419</u>

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 January 3, 2021.

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 \$34.2 million have been issued as of January 3, 2021, primarily to support the Company's insurance programs.

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

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 bore interest at LIBOR plus 1.50% per annum or prime plus 0.5%. 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. As of January 3, 2021, loans under the Amended and Restated Credit Agreement bore interest at LIBOR plus 1.25% per annum or prime plus 0.25%.

The interest rate on 100% of outstanding debt under the Amended and Restated Credit Agreement is fixed, reflecting the effects of floating to fixed interest rate swaps (see Note 22, "Derivative Financial Instruments").

As of January 3, 2021, outstanding letters of credit under the Amended and Restated Credit Agreement were subject to a participation fee of 1.25% 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 2020, the Company made no additional borrowings and made a total of \$288.0 million of principal payments, resulting in total outstanding debt under the Amended and Restated Credit Agreement of \$250 million as of January 3, 2021. During fiscal year 2019, the Company borrowed an additional \$265.4 million, primarily for share repurchases, and made a total of \$180.4 million of principal payments; resulting in total outstanding debt under the Amended and Restated Credit Agreement of \$538.0 million as of December 29, 2019.

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 April 1, 2018.

The Company was in compliance with all applicable covenants under the Amended and Restated Credit Agreement as of January 3, 2021.

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.

14. Other Long-Term Liabilities

A summary of other long-term liabilities is as follows:

	As Of	
	January 3, 2021	December 29, 2019
Long-term portion of self-insurance reserves	\$ 23,291	\$ 24,058
Other	17,621	17,459
Total	<u>\$ 40,912</u>	<u>\$ 41,517</u>

15. Self-Insurance Programs

The Company is self-insured for costs related to workers’ compensation, general liability and employee health benefits up to certain stop-loss limits. The Company establishes reserves for the ultimate obligation of reported and incurred but not reported (“IBNR”) claims. IBNR claims are estimated using various techniques, including analysis of historical trends and actuarial valuation methods.

The Company purchases coverage from third-party insurers for exposures in excess of certain stop-loss limits and recorded receivables of \$1.0 million and a \$1.6 million from its insurance carriers for payments expected to be made in excess of self-insured retentions at January 3, 2021 and December 29, 2019, respectively. The Company recorded amounts for general liability, worker's compensation and team member health benefit liabilities of \$48.5 million and \$46.9 million at January 3, 2021 and December 29, 2019, respectively. See Note 11, "Accrued Liabilities" for current amounts recorded for general liability, workers' compensation and team member health benefit liabilities.

16. Defined Contribution Plan

The Company maintains the Sprouts Farmers Market, Inc. Employee 401(k) Savings Plan (the "Plan"), which is a defined contribution plan covering all eligible team members. Under the provisions of the Plan, participants may direct the Company to defer a portion of their compensation to the Plan, subject to the Internal Revenue Code limitations. The Company provides for an employer matching contribution equal to 50% of each dollar contributed by the participants up to 6% of their eligible compensation.

Total expense recorded for the matching under the Plan:

	Year Ended		
January 3, 2021	December 29, 2019	December 30, 2018	
\$ 6,588	\$ 5,756	\$ 4,981	

17. Income Taxes

On December 22, 2017, the legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Act") was enacted into law, which changed various corporate income tax provisions within the existing Internal Revenue Code. Substantially all the provisions of the Tax Act were effective for taxable years beginning after December 31, 2017. The most significant change that impacted the Company was the reduction in the corporate federal income tax rate from 35% to 21%.

The Company realized a \$2.6 million non-cash income tax benefit in the third quarter of 2018 in the filing of the 2017 return related to the reduction of the federal corporate income tax rate. The Company changed its method of tax accounting on certain items resulting in the acceleration of deductions into prior periods subject to a higher 35% corporate income tax rate.

Income Tax Provision

The income tax provision consists of the following:

	Year Ended		
January 3, 2021	December 29, 2019	December 30, 2018	
U.S. Federal—current.....	\$ 63,957	\$ 36,091	\$ 9,319
U.S. Federal—deferred	3,725	186	19,441
U.S. Federal—total	67,682	36,277	28,760
State—current	20,442	8,649	5,271
State—deferred	1,304	1,613	3,229
State—total	21,746	10,262	8,500
Total provision	\$ 89,428	\$ 46,539	\$ 37,260

Tax Rate Reconciliation

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

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Federal statutory rate	21.0%	21.0%	21.0%
Increase (decrease) in income taxes resulting from:			
State income taxes, net of federal benefit	4.6	4.4	3.8
Enhanced charitable contribution impact	(1.0)	(0.7)	—
Excess tax benefits from share based payments	—	—	(5.2)
Change in uncertain tax position reserves	0.1	(1.1)	1.5
Amended returns	(1.0)	—	—
Benefit of federal tax credit	(0.9)	(1.6)	(0.7)
Other, net	0.9	1.7	(1.4)
Effective tax rate	<u>23.7%</u>	<u>23.7%</u>	<u>19.0%</u>

The effective income tax rate was 23.7% in 2020 and 2019. The effective income tax rate in 2020 was primarily affected by a decrease in federal tax credits and prior year release of uncertain tax positions, partially offset by an increase in charitable contribution deductions and the benefit recognized from amended returns. The effective income tax rate increased to 23.7% in 2019 from 19.0% in 2018 primarily due to the volume of expiring pre-IPO option exercises in 2018, partially offset by an increase in the Company's federal tax credit benefit.

Excess tax benefits or detriments associated with share-based payment awards are recognized as income tax benefits or expense in the income statement. The tax effects of exercised or vested awards are treated as discrete items in the reporting period in which they occur. The income tax detriment resulting from share-based awards were \$0.5 million and \$1.6 million for 2020 and 2019, respectively, and are reflected as an increase to the 2020 and 2019 income tax provisions. The income tax benefit resulting from share-based awards was \$12.4 million for 2018 and is reflected as a reduction to the 2018 income tax provision.

Deferred Taxes

Significant components of the Company's deferred tax assets and deferred tax liabilities are as follows:

	As Of	
	January 3, 2021	December 29, 2019
Deferred tax assets		
Employee benefits	\$ 19,498	\$ 14,663
Tax credits	270	427
Operating leases ⁽¹⁾	309,756	303,950
Other lease related ⁽¹⁾	4,955	5,177
Other accrued liabilities	3,926	5,027
Charitable contribution carryforward	1,028	7,819
Inventories and other	4,504	3,520
Total gross deferred tax assets	<u>343,937</u>	<u>340,583</u>
Deferred tax liabilities		
Depreciation and amortization	(93,738)	(97,309)
Intangible assets	(39,602)	(33,293)
Operating leases ⁽¹⁾	(268,670)	(264,337)
Total gross deferred tax liabilities	<u>(402,010)</u>	<u>(394,939)</u>
Net deferred tax (liability) / asset	<u>\$ (58,073)</u>	<u>\$ (54,356)</u>

(1) The deferred tax assets and liabilities disclosure at December 29, 2019 has been adjusted to reflect the gross deferred tax right-of-use asset and related gross deferred lease liability recognized in accordance with ASC 842.

A valuation allowance is established for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize their benefits, or that the realization of future deductions is uncertain.

Management performs an assessment over future taxable income to analyze whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company has evaluated all available positive and negative evidence and believes it is probable that the deferred tax assets will be realized and has not recorded a valuation allowance against the Company's deferred tax assets as of January 3, 2021 and December 29, 2019.

The Company applies the authoritative accounting guidance under ASC 740 for the recognition, measurement, classification and disclosure of uncertain tax positions taken or expected to be taken in a tax return.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits is as follows:

	As Of		
	January 3, 2021	December 29, 2019	December 30, 2018
Beginning balance	\$ 1,343	\$ 3,658	\$ 794
Additions based on tax positions related to the current year	16	289	2,864
Additions based on tax positions related to prior years	647	—	—
Reductions for tax positions for prior years	(203)	(2,604)	—
Ending balance	<u>\$ 1,803</u>	<u>\$ 1,343</u>	<u>\$ 3,658</u>

The Company had unrecognized tax benefits (tax effected) of \$1.8 million and \$1.3 million as of January 3, 2021 and December 29, 2019, respectively. These would impact the effective tax rate if recognized.

The Company's policy is to recognize accrued interest and penalties as a component of income tax expense.

The Company does not anticipate a decrease in the total amount of unrecognized tax benefits during the next twelve months..

The Company files income tax returns with federal and state tax authorities within the United States. The general statute of limitations for income tax examinations remains open for federal tax returns for tax years 2017 through 2019 and state tax returns for the tax years 2016 through 2019. The Company's U.S. federal income tax return for the fiscal year ended December 31, 2017 is currently under examination by the Internal Revenue Service.

18. Related-Party Transactions

A former member of the Company's board of directors was an investor in a company that is a supplier of coffee to the Company for resale. Effective January 1, 2019, this director no longer held an ownership interest in the supplier and effective June 20, 2019, this director resigned from the Company's board of directors. During 2020 and 2019, there were no purchases from this supplier. During 2018, there were \$2.6 million in purchases. As of January 3, 2021 and December 29, 2019, the Company had no recorded accounts payable due to this vendor.

19. Commitments and Contingencies

Commitments

Real estate obligations, which include legally binding minimum lease payments for leases executed but not yet commenced were \$183.0 million as of January 3, 2021.

In addition to its lease obligations, the Company maintains certain purchase commitments with various vendors to ensure its operational needs are fulfilled. As of January 3, 2021, total future purchase commitments were \$9.0 million.

Commitments related to the Company's business operations cover varying periods of time and are not individually significant. These commitments are expected to be fulfilled with no adverse consequences to the Company's operations or financial conditions.

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 judgments and actual claim settlements and associated expenses may differ from the Company's current provisions for loss. See Note 15, "Self-Insurance Programs" for more information.

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 its underwritten secondary public offering which closed on March 10,

2015 (the “March 2015 Offering”). The complaint purported 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 sought damages on behalf of the purported class in an unspecified amount, rescission, and an award of reasonable costs and attorneys’ fees. On August 4, 2018, the Company reached an agreement in principle to settle these claims. The parties’ settlement agreement was approved by the court on May 31, 2019 and the complaint was subsequently dismissed. The settlement was funded from the Company’s directors and officers liability insurance policy and did not have a material impact on the 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 the Company’s current and former team members whose personally identifiable information (“PII”) was inadvertently disclosed to an unauthorized third party that perpetrated an email “phishing” scam against one of the Company’s team members. The complaints alleged the Company failed to properly safeguard the PII in accordance with applicable law. The complaints sought damages on behalf of the purported class in unspecified amounts, attorneys’ fees and litigation expenses. On March 1, 2019, a number of individual plaintiffs filed arbitration demands. On May 15, 2019, certain other plaintiffs filed a second amended class action complaint in the District of Arizona, alleging that certain subclasses of team members are not subject to the Company’s arbitration agreement and attempted to pursue those team members’ claims in federal court. In late August 2019, the Company reached an agreement in principle to settle the majority of these claims, which were funded in the fourth quarter of 2019. Primary funding for the settlement came from the Company’s cyber insurance policy, and the settlement did not have a material impact on the consolidated financial statements. Following the group settlement, three (3) individual claimants planned to proceed with arbitration of their claims. The three individual arbitrations were settled in late June and early July 2020, with immaterial settlement amounts fully funded by the Company’s cyber insurance policy.

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 the Company. CERT alleged 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.

The 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.” The proposed regulation has been finalized with an effective date of October 1, 2019. The defendants have amended their answers to assert the regulation as an affirmative defense. On August 25, 2020, the court granted the defense motion for summary judgment on the affirmative defense, and the case was dismissed.

On November 20, 2020, CERT filed a notice of appeal to appeal the ruling on the defense motion for summary judgment. At this stage of the proceedings, the Company is unable to predict or reasonably estimate any potential loss or effect on the Company or its operations. Accordingly, no loss contingency was recorded for this matter.

20. Capital Stock

Common stock

As of January 3, 2021, 117,953,435 shares of the Company's common stock were issued and outstanding after the repurchase and retirement of no shares in 2020 and the repurchase and retirement of 7,950,858 shares during 2019, as described below. As of January 3, 2021, 4,433,820 shares of common stock are reserved for issuance under the 2013 Incentive Plan (see Note 26, "Share-Based Compensation"). The following table outlines the options exercised in exchange for the issuance of shares of common stock during 2020, 2019, and 2018.

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Options exercised	59,561	316,493	2,824,460
Other share issuances under stock plans	440,956	506,093	403,233

Share Repurchases

On February 20, 2018, the Company's board of directors authorized a new \$350 million common stock share repurchase program, replacing the previous share repurchase program which was completed in the second quarter of 2018. Upon this authorization's December 31, 2019 expiration, \$42.0 million remained unused. The Company's board of directors has not authorized additional share repurchases subsequent to the expiration of the prior authorization on December 31, 2019, and there was no share repurchase authorization available as of January 3, 2021.

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 13, "Long-Term Debt and Finance Lease Liabilities").

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

	Year Ended	
	January 3, 2021	December 29, 2019
Number of common shares acquired	—	7,950,858
Average price per common share acquired	\$ —	\$ 22.18
Total cost of common shares acquired	\$ —	\$ 176,310

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

Preferred Stock

The Company's board of directors is authorized, subject to limitations prescribed by Delaware law, to issue up to 10,000,000 shares of the Company's preferred stock in one or more series, to establish from time to time the number of shares to be included in each series, to fix the designation, powers, preferences, and rights of the shares of each series and any of its qualifications, limitations, or restrictions, in each case without further action by the Company's stockholders. The Company's board of directors can also increase or decrease the number of shares of any series of preferred stock, but not below the number of shares of that series then outstanding. The Company's board of directors may

authorize the issuance of preferred stock with voting or conversion rights that could adversely affect the voting power or other rights of the holders of the common stock. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could, among other things, have the effect of delaying, deferring, or preventing a change in control of the Company and might adversely affect the market price of the Company's common stock and the voting and other rights of the holders of the Company's common stock. The Company has no current plan to issue any shares of preferred stock.

21. 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.

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):

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Basic net income per share:			
Net income.....	\$ 287,450	\$ 149,629	\$ 158,536
Weighted average shares outstanding	117,821	119,368	128,827
Basic net income per share	\$ 2.44	\$ 1.25	\$ 1.23
Diluted net income per share:			
Net income.....	\$ 287,450	\$ 149,629	\$ 158,536
Weighted average shares outstanding	117,821	119,368	128,827
Dilutive effect of equity-based awards:			
Assumed exercise of options to purchase			
shares	16	52	429
Restricted Stock Units	341	178	220
Restricted Stock Awards.....	9	55	136
Performance Share Awards.....	37	89	164
Weighted average shares and equivalent			
shares outstanding	118,224	119,742	129,776
Diluted net income per share	\$ 2.43	\$ 1.25	\$ 1.22

For the year ended January 3, 2021, the Company had 219,736 options, 62,347 RSUs and 299,629 PSAs outstanding which were excluded from the computation of diluted net income per share as those awards would have been antidilutive or were performance awards with performance conditions not yet deemed met. For the year ended December 29, 2019, the Company had 521,502 options and 302,621 PSAs outstanding which were excluded from the computation of diluted net income per share as those awards would have been antidilutive or were performance awards with performance conditions not yet deemed met. For the year ended December 30, 2018, the Company had 1,105,334 options and 128,854 PSAs which were excluded from the computation of diluted net income per share as those awards would have been antidilutive or were performance awards with performance conditions not yet deemed met.

22. 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 consisted of five cash flow hedges, of which two remain outstanding as of January 3, 2021. 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 two outstanding swaps was \$250.0 million at January 3, 2021, under which the Company pays a fixed rate and receives a variable rate of interest (cash flow swap). The cash flow swaps hedge the change in interest rates on debt related to fluctuations in interest rates and each have a length of one year and mature annually from 2021 to 2022. These interest rate swaps have been designated and qualify as cash flow hedges and have met the requirements to assume zero ineffectiveness. The Company reviews the effectiveness of its hedging instruments on a quarterly basis.

The counterparties to these derivative financial instruments are major financial institutions. The Company evaluates the credit ratings of the financial institutions and believes that credit risk is at an acceptable level.

The following table summarizes the fair value of the Company's derivative instruments:

	As of January 3, 2021		As of December 29, 2019	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate swaps	Accrued liabilities	\$ 5,695	Accrued liabilities	\$ 1,736
Interest rate swaps	Other long-term liabilities	5,756	Other long-term liabilities	4,569

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, net on the consolidated statement of income. The following table summarizes these gains and losses for 2020 and 2019:

Consolidated Statements of Income Classification	Year Ended	
	January 3, 2021	December 29, 2019
Interest expense (income), net	\$ 4,307	\$ (256)

23. Comprehensive Income

The following table presents the changes in accumulated other comprehensive income (loss) for the year ended January 3, 2021:

	<u>Cash Flow Hedges</u>
Balance at December 30, 2018	\$ 1,134
Other comprehensive income (loss), net of tax	
Unrealized losses on cash flow hedging activities, net of income tax of (\$2,078)	(6,006)
Reclassification of net gains on cash flow hedges to net income, net of income tax of \$66	190
Total other comprehensive income (loss)	<u>(5,816)</u>
Balance at December 29, 2019	\$ (4,682)
Other comprehensive income (loss), net of tax	
Unrealized losses on cash flow hedging activities, net of income tax of (\$205)	(592)
Reclassification of net losses on cash flow hedges to net income, net of income tax of (\$1,107)	(3,200)
Total other comprehensive income (loss)	<u>(3,792)</u>
Balance at January 3, 2021	<u>\$ (8,474)</u>

Amounts reclassified from accumulated other comprehensive income (loss) to net income are included within interest expense, net on the consolidated statement of income. The estimated amount expected to be reclassified from accumulated other comprehensive income (loss) to net income within the next twelve months, based on interest rates at January 3, 2021, is a loss of \$5.7 million.

24. Fair Value Measurements

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

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

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

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

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

The following tables present the Company's fair value hierarchy for the Company's financial assets and liabilities measured at fair value on a recurring basis as of January 3, 2021 and December 29, 2019:

January 3, 2021	Level 1	Level 2	Level 3	Total
Long-term debt	\$ —	\$ 250,000	\$ —	\$ 250,000
Interest rate swap liability	—	11,451	—	11,451
Total liabilities.....	<u>\$ —</u>	<u>\$ 261,451</u>	<u>\$ —</u>	<u>\$ 261,451</u>

December 29, 2019	Level 1	Level 2	Level 3	Total
Long-term debt	\$ —	\$ 538,000	\$ —	\$ 538,000
Interest rate swap liability	—	6,305	—	6,305
Total liabilities.....	<u>\$ —</u>	<u>\$ 544,305</u>	<u>\$ —</u>	<u>\$ 544,305</u>

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

The determination of fair values of certain tangible and intangible assets for purposes of the Company's goodwill or long-lived asset impairment evaluation as described above is based upon Level 3 inputs. When necessary, the Company uses third party market data and market participant assumptions to derive the fair value of its asset groupings, which primarily include right-of-use lease assets and property and equipment. For further details, see Note 3, "Significant Accounting Policies – Impairment of Long-lived Assets".

Cash, cash equivalents, and restricted cash, accounts receivable, prepaid expenses and other current assets, accounts payable and 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 January 3, 2021 and December 29, 2019.

25. 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 fiscal 2020 and 2019.

	Year Ended			
	January 3, 2021		December 29, 2019	
Perishables	\$ 3,700,878	57.2%	\$ 3,252,928	57.7%
Non-Perishables	2,767,881	42.8%	2,381,907	42.3%
Net Sales	<u>\$ 6,468,759</u>	<u>100.0%</u>	<u>\$ 5,634,835</u>	<u>100.0%</u>

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.

26. Share-Based Compensation

2013 Incentive Plan

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

The Company granted to certain officers, directors and team members the following awards during 2019, under the 2013 Incentive Plan:

<u>Grant Date</u>	<u>Award Type</u>	<u>Shares of common stock</u>	<u>Exercise Price</u>	<u>Grant date fair value</u>
March 4, 2019.....	RSUs	386,115	—	\$ 23.12
	PSAs	95,768	—	\$ 23.12
	Options	53,866	\$ 23.12	\$ 7.63
May 13, 2019.....	RSUs	45,682	—	\$ 21.70
	PSAs	2,999	—	\$ 21.70
June 24, 2019.....	RSUs	177,975	—	\$ 18.64
	PSAs	75,000	—	\$ 18.64
August 12, 2019	RSUs	12,313	—	\$ 17.54
December 3, 2019	RSUs	3,159	—	\$ 20.22

The RSUs vest either one-third each year for three years or one-half each year for two years for team members. RSUs granted to independent members of the Company's board of directors cliff vest in one year. The options expire seven years from grant date. The PSAs are described below.

The Company granted to certain officers, directors and team members the following awards during 2020, under the 2013 Incentive Plan:

<u>Grant Date</u>	<u>Award Type</u>	<u>Shares of common stock</u>	<u>Exercise Price</u>	<u>Grant date fair value</u>
March 9, 2020.....	RSUs	485,367	—	\$ 16.47
	PSAs	174,902	—	\$ 16.47
	Options	1,055,907	\$ 16.47	\$ 4.86
May 12, 2020.....	RSUs	66,550	—	\$ 25.58
	PSAs	11,389	—	\$ 25.58
	Options	15,569	\$ 25.58	\$ 8.03
August 10, 2020	RSUs	35,655	—	\$ 24.77
	PSAs	5,762	—	\$ 24.77
	Options	14,052	\$ 24.77	\$ 7.74

The RSUs vest either one-third each year for three years or one-half each year for two years for team members. RSUs granted to independent members of the Company's board of directors cliff vest in one year. The options expire seven years from grant date. The PSAs are described below.

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 January 3, 2021, there were 2,547,567 stock awards outstanding and 4,433,820 shares remaining available for issuance under the 2013 Incentive Plan.

Stock Options

In the event of a change in control as defined in the award agreements issued under the 2013 Incentive Plan, all options and awards issued prior to 2015 become immediately vested and exercisable. For grants issued in and subsequent to 2015, the options and awards only become immediately vested in the event of a change in control (as defined in the applicable team member award agreement) if the grants are not continued or assumed by the acquirer on a substantially equivalent basis. If the options and awards continue or are assumed on a substantially equivalent basis, but employment is terminated by the Company or an acquirer without cause or by the team member for good reason (as such terms are defined in the applicable team member award agreement) within 24 months following the change in control, such options or awards will become immediately vested upon such termination. Under all other scenarios, the awards continue to vest per the schedule outlined in the applicable award agreement.

Shares issued for option exercises are newly issued shares.

The estimated weighted average fair values of options granted during 2020, 2019, and 2018 are \$4.94, \$7.63 and \$7.80, respectively, and were calculated using the following assumptions in the table below:

	2020	2019	2018
Dividend yield	0.00%	0.00%	0.00%
Expected volatility.....	34.80%	34.89%	35.20%
Risk free interest rate	0.46%	2.53%	2.76%
Expected term, in years.....	4.50	4.50	4.50

The grant date weighted average fair value of the 1.1 million options issued but not vested as of January 3, 2021 was \$5.00. The grant date weighted average fair value of the 0.1 million options issued but not vested as of December 29, 2019 was \$7.63. The grant date weighted average fair value of the 0.1 million options issued but not vested as of December 30, 2018 was \$8.35.

The following table summarizes grant date weighted average fair value of options granted and options forfeited:

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Grant date weighted average fair value of options granted	\$ 4.94	\$ 7.63	\$ 7.80
Grant date weighted average fair value of options forfeited	\$ 8.94	\$ 7.03	\$ 9.32

Expected volatility for option grants and modifications are calculated based upon the Company's historical volatility data over a time frame consistent with the expected life of the awards. The expected term is estimated based on the expected period that the options are anticipated to be outstanding after initial grant until exercise or expiration based upon various factors including the contractual terms of the awards and vesting schedules. The expected risk-free rate is based on the U.S. Treasury yield curve rates in effect at the time of the grant using the term most consistent with the expected life of the award. Dividend yield was estimated at zero as the Company does not anticipate making regular future distributions to stockholders. The total intrinsic value of options exercised was \$0.2 million, \$2.1 million, and \$53.3 million for 2020, 2019, and 2018, respectively.

The following table summarizes option activity during 2020:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Outstanding at December 29, 2019.....	523,725	\$ 29.84		
Granted.....	1,085,528	16.71		
Forfeited.....	(219,484)	31.41		
Exercised.....	(59,561)	22.56		\$ 156
Outstanding at January 3, 2021.....	<u>1,330,208</u>	19.19	<u>5.30</u>	<u>\$ 3,784</u>
Exercisable—January 3, 2021.....	<u>234,703</u>	30.13	<u>1.27</u>	<u>\$ —</u>
Vested/Expected to vest—January 3, 2021.....	<u>1,330,208</u>	\$ 19.19	<u>5.30</u>	<u>\$ 3,784</u>

RSUs

In the event of a change in control as defined in the award agreements issued under the 2013 Incentive Plan, all RSUs granted prior to 2015 become immediately vested. RSUs granted in and subsequent to 2015 only become immediately vested in the event of a change in control (as defined in the applicable team member award agreement) if the awards are not continued or assumed by the acquirer on a substantially equivalent basis. If the awards continue or are assumed on a substantially equivalent basis, but employment is terminated by the Company or an acquirer without cause or by the team member for good reason (as such terms are defined in the applicable team member award agreement) within 24 months following the change in control, such awards will become immediately vested upon such termination. Under all other scenarios, the awards continue to vest per the schedule outlined in the applicable award agreement.

Shares issued for RSU vesting are newly issued shares.

The fair value for restricted stock units is calculated based on the closing stock price on the date of grant. The total grant date fair value of RSUs vested during 2020, 2019 and 2018 was \$7.8 million, \$7.4 million and \$5.1 million, respectively.

The following table summarizes the weighted average grant date fair value of RSUs awarded during 2020, 2019, and 2018:

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
RSUs awarded	\$ 18.01	\$ 21.62	\$ 24.80

The following table summarizes RSU activity during 2020:

	Number of RSUs	Weighted Average Grant Date Fair Value
Outstanding at December 29, 2019.....	725,653	\$ 22.02
Awarded.....	587,572	18.01
Released.....	(350,206)	22.23
Forfeited.....	(60,761)	20.55
Outstanding at January 3, 2021.....	<u>902,258</u>	\$ 19.43

PSAs

PSAs granted in fiscal year 2016 were restricted shares that were subject to the Company achieving certain earnings before interest and taxes (“EBIT”) performance targets on an annual and cumulative basis over a three-year performance period, as well as additional time-vesting conditions. The EBIT target for each of the three years during the performance period was 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 was based on the aggregate annual performance and was measured against a cumulative performance target. Payout of the performance shares was either to have been 0% or range from 50% to 150% of the target number of shares granted, depending upon goal achievement. If the performance conditions had been met, the applicable number of performance shares was subject to cliff vesting on the third anniversary of the grant date (March 2019); however, neither the annual nor cumulative performance conditions were deemed to have been 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 vested 50% on the second anniversary of the grant date (March 2019) and the remaining 50% vested on the third anniversary of the grant date (March 2020). During the year ended January 3, 2021, 35,697 of the 2017 PSAs vested. There were no outstanding 2017 PSAs as of January 3, 2021.

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

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

PSAs granted in 2020 are subject to the Company achieving certain earnings before taxes (“EBT”) performance targets for the 2022 fiscal year. The criteria is based on a range of performance targets in which grantees may earn 0% to 200% of the base number of awards granted. If performance conditions are met, the applicable number of performance shares will vest on the third anniversary of the grant date (March 2023).

The PSAs only become immediately vested in the event of a change in control (as defined in the applicable team member award agreement) if the awards are not continued or assumed by the acquirer on a substantially equivalent basis. If the awards continue or are assumed on a substantially equivalent basis, but employment is terminated by the Company or an acquirer without cause or by the team member for good reason (as such terms are defined in the applicable team member award agreement) within 24 months following the change in control, such awards will become immediately vested upon such termination. Under all other scenarios, the awards continue to vest per the schedule outlined in the applicable team member award agreement.

Shares issued for PSA vesting are newly issued shares.

The fair value for performance stock awards is calculated based on the closing stock price on the date of grant.

The total grant date fair value of PSAs granted during 2020 was \$3.3 million. The total grant date fair value of PSAs vested during 2020 was \$0.6 million. The total grant date fair value of performance shares forfeited or not earned during 2020 was \$0.3 million. The total grant date fair value of the 0.3 million PSAs issued but not released as of January 3, 2021 was \$5.8 million.

The total grant date fair value of PSAs granted during 2019 was \$3.7 million. The total grant date fair value of PSAs vested during 2019 was \$1.9 million. The total grant date fair value of performance shares forfeited or not earned during 2019 was \$3.9 million. The total grant date fair value of the 0.2 million PSAs issued but not released as of December 29, 2019 was \$3.4 million.

The total grant date fair value of PSAs granted during 2018 was \$3.2 million. The total grant date fair value of PSAs vested during 2018 was \$0.7 million. The total grant date fair value of performance shares forfeited or not earned during 2018 was \$3.5 million. The total grant date fair value of the 0.3 million PSAs issued but not released as of December 30, 2018 was \$5.5 million.

The following table summarizes PSA activity during 2020:

	Number of PSAs	Weighted Average Grant Date Fair Value
Outstanding at December 29, 2019	169,771	\$ 20.26
Awarded	192,053	17.26
Released	(35,697)	18.11
Forfeited	(10,726)	24.08
PSA earned	—	—
PSAs not earned	—	—
Outstanding at January 3, 2021	<u>315,401</u>	\$ 18.54

RSAs

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

The RSAs only become immediately vested in the event of a change in control (as defined in the applicable team member award agreement) if the awards are not continued. If the awards continue, but employment is terminated by the Company or an acquirer without cause or by the team member for good reason (as such terms are defined in the applicable team member award agreement) within 24 months following the change in control, such awards will become immediately vested upon such termination. Under all other scenarios, the awards continue to vest per the schedule outlined in the applicable team member award agreement.

Shares issued for RSA vesting are newly issued shares. The fair value for restricted stock awards is calculated based on the closing stock price on the date of grant.

There were no RSAs granted during 2020, 2019 or 2018. The total grant date fair value of shares of restricted stock released upon vesting during 2020, 2019 and 2018 was \$1.0 million, \$1.6 million and \$3.3 million, respectively. There were no RSAs forfeited in 2020, and the total grant date fair value of shares of restricted stock forfeited during 2019 and 2018 was \$0.3 million and \$0.6 million, respectively. There were no outstanding RSAs as of January 3, 2021.

The following table summarizes RSA activity during 2020:

	Number of RSAs	Weighted Average Grant Date Fair Value
Outstanding at December 29, 2019	55,053	\$ 18.11
Awarded	—	—
Released	(55,053)	18.11
Forfeited	—	—
Outstanding at January 3, 2021	<u>—</u>	<u>\$ —</u>

Share-Based Compensation Expense

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

	Year Ended		
	January 3, 2021	December 29, 2019	December 30, 2018
Share-based compensation expense			
before income taxes	\$ 14,339	\$ 8,949	\$ 14,512
Income tax benefit	(2,662)	(2,093)	(3,383)
Net share-based compensation expense	<u>\$ 11,677</u>	<u>\$ 6,856</u>	<u>\$ 11,129</u>

As of January 3, 2021, total unrecognized compensation expense and remaining weighted average recognition period related to outstanding share-based awards were as follows:

	Unrecognized compensation expense	Remaining weighted average recognition period
Options	\$ 3,971	2.2
RSUs	10,886	1.6
PSAs	6,709	1.7
RSAs	—	—
Total unrecognized compensation expense at January 3, 2021	<u>\$ 21,566</u>	

During 2020, 2019 and 2018, the Company received \$1.3 million, \$4.9 million and \$21.8 million in cash proceeds from the exercise of options, respectively.

The Company recorded tax detriments of \$0.5 million and \$1.6 million during 2020 and 2019, respectively, resulting from share-based awards. During 2018, the company recorded \$12.4 million of excess tax benefits from the exercise of options.

Share Award Restructuring

During the year ended December 29, 2019, certain stock options and awards were modified pursuant to a separation agreement with the Company's former President and Chief Operating Officer. A total of 216,044 options and awards (RSUs, PSAs, and RSAs) were modified such that they will be permitted to vest in March 2020, which is subsequent to the former President and Chief Operating Officer's separation date. These options and awards will expire three months after vesting, consistent with the other modified options and awards. These modifications resulted in an incremental expense, net of \$1.0 million of stock compensation reversals, of \$0.2 million during the year ended December 29, 2019. All other unvested options and awards were forfeited. This expense was presented in store closure and other costs, net on the Company's consolidated statements of income.

During the year ended December 30, 2018, certain stock options were modified pursuant to a separation agreement with the Company's former Chief Executive Officer. A total of 995,937 vested options were modified such that their remaining exercise period was increased from three months to six months after the separation date. Additionally, a total of 125,241 options and awards (RSUs, PSAs, and RSAs) were modified such that they will be permitted to vest in March 2019, which is subsequent to the former Chief Executive Officer's separation date. These options and awards will expire three months after vesting, consistent with the other modified options. These modifications resulted in an incremental expense, net of \$2.5 million of stock compensation reversals, of \$0.2 million during the year ended December 30, 2018. All other unvested options and awards were forfeited. This expense was presented in store closure and other costs, net on the Company's consolidated statements of income.

27. Quarterly Financial Data (Unaudited)

The following table sets forth certain of the Company's unaudited consolidated statements of income data for each of the fiscal quarters in 2020 and 2019.

	Fiscal Quarter Ended							
	January 3, 2021	September 27, 2020	June 28, 2020	March 29, 2020	December 29, 2019	September 29, 2019	June 30, 2019	March 31, 2019
	(dollars in thousands, except per share amounts)							
Net sales	\$ 1,601,834	\$ 1,577,598	\$ 1,642,788	\$ 1,646,539	\$ 1,364,991	\$ 1,440,222	\$ 1,415,736	\$ 1,413,887
Gross profit	\$ 588,029	\$ 584,769	\$ 612,659	\$ 593,832	\$ 468,963	\$ 476,725	\$ 464,782	\$ 484,349
Income from operations ...	\$ 92,932	\$ 78,381	\$ 92,763	\$ 127,589	\$ 46,915	\$ 39,557	\$ 51,332	\$ 79,556
Net income	\$ 68,397	\$ 60,241	\$ 67,002	\$ 91,810	\$ 31,634	\$ 26,260	\$ 35,343	\$ 56,392
Net income per share:								
Basic	\$ 0.58	\$ 0.51	\$ 0.57	\$ 0.78	\$ 0.27	\$ 0.22	\$ 0.30	\$ 0.46
Diluted	\$ 0.58	\$ 0.51	\$ 0.57	\$ 0.78	\$ 0.27	\$ 0.22	\$ 0.30	\$ 0.46

The Company follows the same accounting policies for preparing quarterly and annual financial data and, in the opinion of management, the amounts above reflect all normal and recurring adjustments necessary for a fair statement of results for the interim periods presented. Annual amounts may not sum due to rounding. Annual period 2020 represents a 53-week fiscal year and annual period 2019 represents a 52-week fiscal year.

Item 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

Item 9A. *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 periods 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 January 3, 2021, the end of the period covered by this Annual Report on Form 10-K. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of January 3, 2021, our disclosure controls and procedures are effective.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

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

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we assessed the effectiveness of our internal control over financial reporting as of January 3, 2021, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework (2013 Framework). Based on this assessment, our management has concluded that our internal control over financial reporting was effective as of January 3, 2021.

PricewaterhouseCoopers LLP, our independent registered public accounting firm, assessed the effectiveness of our internal control over financial reporting as of January 3, 2021, as stated in the firm's report which is included with the consolidated financial statements in Item 8 of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarterly period ended January 3, 2021 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. *Other Information*

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item will be contained in our definitive Proxy Statement to be filed with the SEC in connection with our 2021 Annual Meeting of Stockholders (referred to as the “Proxy Statement”), which is expected to be filed not later than 120 days after the end of our fiscal year ended January 3, 2021, and is incorporated herein by reference.

We have adopted a Code of Ethics – Principal Executive Officer and Senior Financial Officers (referred to as the “Code”) that applies to our principal executive officer, principal financial officer and principal accounting officer and controller. The Code is publicly available on our website at <http://investors.sprouts.com/governance-information>.

We will provide disclosure of future updates, amendments or waivers from the Code by posting them to our investor relations website located at investors.sprouts.com. The information contained on or accessible through our website is not incorporated by reference into this Annual Report on Form 10-K. Except for such Code, the information contained on or accessible through our website is not incorporated by reference into this Annual Report on Form 10-K.

Item 11. Executive Compensation

The information required by this Item will be set forth in the Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item will be set forth in the Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item will be set forth in the Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item will be set forth in the Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents filed as part of this report:

1. Financial Statements: The information concerning our financial statements and Report of Independent Registered Public Accounting Firm required by this Item is incorporated by reference herein to the section of this Annual Report on Form 10-K in Item 8, titled “Financial Statements and Supplementary Data.”
2. Financial Statement Schedules: No schedules are required.
3. Exhibits: See Item 15(b) below.

(b) Exhibits:

<u>Exhibit Number</u>	<u>Description</u>
2.1	Plan of Conversion of Sprouts Farmers Markets, LLC (1)
3.1	Certificate of Incorporation of Sprouts Farmers Market, Inc. (1)
3.2	Amended and Restated Bylaws of Sprouts Farmers Market, Inc. (2)
4.1	Description of Sprouts Farmers Market, Inc. Securities (3)
10.1	Sprouts Farmers Market, Inc. 2013 Incentive Plan, amended as of May 1, 2015 (4)
10.1.1	Form of Stock Option Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan (5)
10.1.2(a)	Form of Restricted Stock Unit Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan (5)
10.1.2(b)	2019 Form of Restricted Stock Unit Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan for Chief Executive Officer (6)
10.1.3(a)	2018 Form of Performance Share Award Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan (7)
10.1.3(b)	2019 Form of Performance Share Award Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan (8)
10.1.3(c)	2019 Form of Performance Share Award Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan for Chief Executive Officer (6)
10.1.3(d)	2020 Form of Performance Share Award Agreement under Sprouts Farmers Market, Inc. 2013 Incentive Plan (9)
10.2	Employment Transition Agreement, dated August 1, 2019, by and between Sprouts Farmers Market, Inc. and Jim Nielsen (10)
10.3†	Distribution Agreement, dated as of July 18, 2018, by and between SFM, LLC dba Sprouts Farmers Market and KeHE Distributors, LLC (11)
10.4	Form of Indemnification Agreement by and between Sprouts Farmers Market, Inc. and its directors and officers (12)
10.5	Amended and Restated Credit Agreement, dated as of March 27, 2018, among Sprouts Farmers Market, Inc., Sprouts Farmers Markets Holdings, LLC, the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, Bank of America, N.A., as Syndication Agent, and BMO Harris Bank N.A., Coöperatieve Centrale Raiffeisen – Boerenleenbank, B.A. “Rabobank Nederland,” New York Branch, Wells Fargo Bank, N.A., and SunTrust Bank, as Documentation Agents (13)
10.5.1	Amendment No. 1 to Amended and Restated Credit Agreement, dated as of March 6, 2019, among Sprouts Farmers Markets Holdings, LLC, the Lenders party thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent (14)
10.6	Form of Confidentiality, Non-Competition, and Non-Solicitation Agreement (15)
10.7	Amended and Restated Executive Severance and Change in Control Plan (16)
10.8†	Deli, Cheese, and Bakery Distribution Agreement, dated as of February 12, 2016, by and between SFM, LLC dba Sprouts Farmers Market and KeHE Distributors, LLC (17)
21.1	List of subsidiaries

23.1	Consent of PricewaterhouseCoopers LLP, independent registered accounting firm
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	Inline XBRL Instance Document
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

† Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment previously submitted separately to the SEC.

- (1) Filed as an exhibit to Amendment No. 4 to the Registrant's Registration Statement on Form S-1 (File No. 333-188493) filed with the SEC on July 29, 2013, and incorporated herein by reference.
- (2) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on January 30, 2017, and incorporated herein by reference.
- (3) Filed as an exhibit to the Registrant's Annual Report on Form 10-K filed with the SEC on February 20, 2020, and incorporated herein by reference.
- (4) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on May 5, 2015, and incorporated herein by reference.
- (5) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 7, 2015, and incorporated herein by reference.
- (6) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 1, 2019, and incorporated herein by reference.
- (7) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 3, 2018, and incorporated herein by reference.
- (8) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 2, 2019, and incorporated herein by reference.
- (9) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 5, 2020, and incorporated herein by reference.
- (10) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on August 1, 2019, and incorporated herein by reference.
- (11) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2019, and incorporated herein by reference.
- (12) Filed as an exhibit to the Registrant's Registration Statement on Form S-1 (File No. 333-188493) filed with the SEC on May 9, 2013, and incorporated herein by reference.
- (13) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on March 27, 2018, and incorporated herein by reference.
- (14) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on March 7, 2019, and incorporated herein by reference.
- (15) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 6, 2015, and incorporated herein by reference.
- (16) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on February 28, 2020, and incorporated herein by reference.
- (17) Filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 4, 2016, and incorporated herein by reference.

Item 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: February 25, 2021

By: /s/ Denise A. Paulonis

Name: Denise A. Paulonis

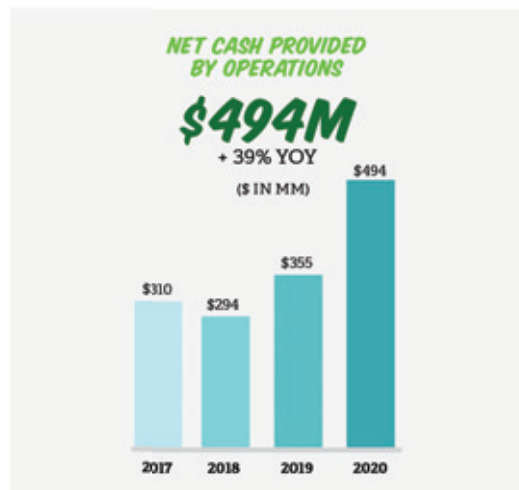
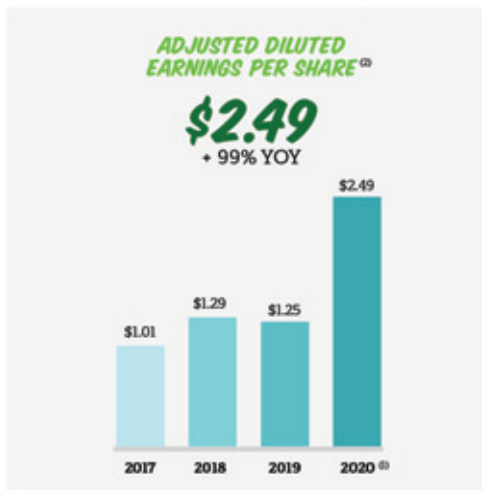
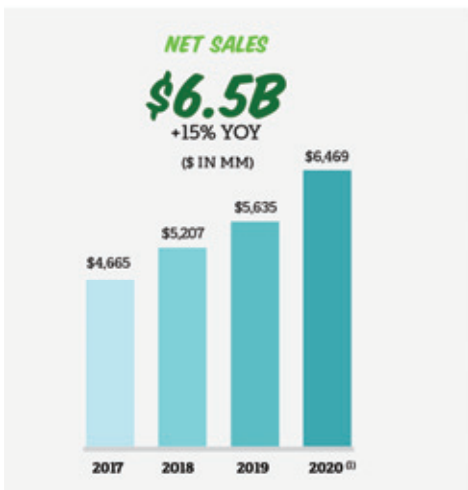
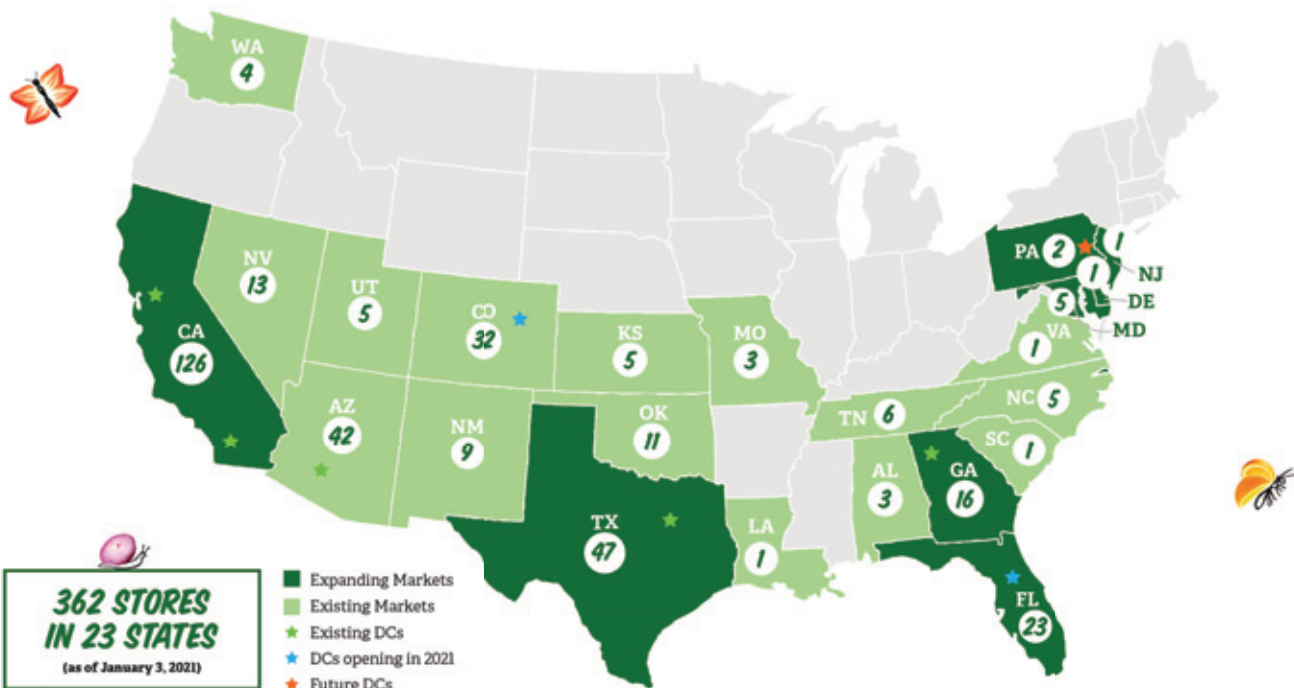
Title: Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Jack L. Sinclair</u> Jack L. Sinclair	Director and Chief Executive Officer (Principal Executive Officer)	February 25, 2021
<u>/s/ Denise A. Paulonis</u> Denise A. Paulonis	Chief Financial Officer (Principal Financial Officer)	February 25, 2021
<u>/s/ Stacy W. Hilgendorf</u> Stacy W. Hilgendorf	Vice President, Controller (Principal Accounting Officer)	February 25, 2021
<u>/s/ Joseph Fortunato</u> Joseph Fortunato	Chairman of the Board	February 25, 2021
<u>/s/ Joel D. Anderson</u> Joel D. Anderson	Director	February 25, 2021
<u>/s/ Kristen E. Blum</u> Kristen E. Blum	Director	February 25, 2021
<u>/s/ Terri Funk Graham</u> Terri Funk Graham	Director	February 25, 2021
<u>/s/ Lawrence P. Molloy</u> Lawrence P. Molloy	Director	February 25, 2021
<u>/s/ Joseph D. O'Leary</u> Joseph D. O'Leary	Director	February 25, 2021
<u>/s/ Douglas G. Rauch</u> Douglas G. Rauch	Director	February 25, 2021



ONE OF THE NATION'S FASTEST GROWING RETAILERS



(1) See the Company's SEC filings. Full-year 2020 is presented on a 53-week basis.
(2) See the Company's SEC filings for a reconciliation of diluted EPS to adjusted diluted EPS.

ABOUT SPROUTS

OUR EXECUTIVE TEAM

Jack Sinclair
Chief Executive Officer

Denise Paulonis
Chief Financial Officer

Scott Neal
Chief Fresh Merchandising Officer

Gil Phipps
Senior Vice President,
Chief Marketing Officer

Dan Sanders
Chief Operations Officer

Dave McGlinchey
Chief Format Officer

Brandon Lombardi
Chief Legal Officer

OUR BOARD

Joseph Fortunato, Chairman of the Board; Operating Partner, Prospect Hills Growth Partners, L.P.; Former Chairman and Chief Executive Officer, GNC Holdings, Inc.

Joel Anderson, President, Chief Executive Officer and Director of Five Below, Inc.

Kristen Blum, Former Senior Vice President and Chief Information Officer, PepsiCo, Inc.-Latin America

Terri Funk Graham, Branding Strategy Consultant; Former Senior Vice President and Chief Marketing Officer, Jack in the Box, Inc.

Lawrence Molloy, Former Chief Financial Officer, PetSmart, Inc.

Joseph O'Leary, Former President and Chief Operating Officer, PetSmart, Inc.

Doug Rauch, President, Daily Table; Former President, Trader Joe's Company

Jack Sinclair, Chief Executive Officer, Sprouts Farmers Market, Inc.

VIRTUAL ANNUAL MEETING

May 26, 2021 - 8 a.m. PDT
Via webcast at
www.virtualshareholdermeeting.com/SFM2021

STOCK LISTING

NASDAQ Global Select Market: SFM

TRANSFER AGENT

American Stock Transfer & Trust Co.
Shareholder Services: 800-937-5449
astfinancial.com

INDEPENDENT AUDITOR

PricewaterhouseCoopers LLP

INVESTOR RELATIONS

investorrelations@sprouts.com

SUPPORT OFFICE

5455 E. High Street, Suite 111, Phoenix, AZ 85054
480-814-8016

This Annual Report contains "forward-looking statements" that 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. For more information, see the section titled "Special Note Regarding Forward-Looking Statements" included in the Annual Report on Form 10-K included herewith.

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