

Natural Grocers by Vitamin Cottage, Inc.  
Form 10-Q  
August 03, 2017  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**COMMISSION FILE NUMBER: 001-35608**

**Natural Grocers by Vitamin Cottage, Inc.**



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

The number of shares of the registrant's common stock, \$0.001 par value, outstanding as of July 31, 2017 was 22,434,931.

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**Natural Grocers by Vitamin Cottage, Inc.**

**Quarterly Report on Form 10-Q**

**For the Quarterly Period Ended June 30, 2017**

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*Except where the context otherwise requires or where otherwise indicated, all references herein to “we,” “us,” “our,” “Natural Grocers,” and the “Company” refer collectively to Natural Grocers by Vitamin Cottage, Inc. and its consolidated subsidiaries.*

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q (this Form 10-Q) includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 in addition to historical information. These forward-looking statements are included throughout this Form 10-Q, including in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” All statements that are not statements of historical fact, including those that relate to matters such as our industry, business strategy, goals and expectations concerning our market position, future operations, margins, profitability, capital expenditures, liquidity and capital resources, future growth, pending legal proceedings and other financial and operating information, are forward-looking statements. We may use the words “anticipate,” “assume,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potentially,” “project,” “future,” “target” and similar terms and phrases to identify forward-looking statements in this Form 10-Q.

The forward-looking statements contained in this Form 10-Q are based on management’s current expectations and are subject to uncertainty and changes in circumstances. We cannot assure you that future developments affecting us will be those that we have anticipated. Actual results may differ materially from these expectations due to changes in global, regional or local political, economic, business, competitive, market, regulatory and other factors, many of which are beyond our control. We believe that these factors include those referenced in Item 1A – “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 (the Form 10-K) and Item 1A – “Risk Factors” in this Form 10-Q. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, our actual results may vary in material respects from those projected in these forward-looking statements.

Any forward-looking statement made by us in this Form 10-Q speaks only as of the date of this report. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by any applicable securities laws. You are advised, however, to consult any further disclosures we may make in our future reports filed with the Securities and Exchange Commission (the SEC). Such reports may be read and copied at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 and may also be accessed on the SEC’s website at [www.sec.gov](http://www.sec.gov). Our filings with the SEC are also available, free of charge, through our website at [www.naturalgrocers.com](http://www.naturalgrocers.com).



Table of Contents**PART I. Financial Information****Item 1. Financial Statements****NATURAL GROCERS BY VITAMIN COTTAGE, INC.****Consolidated Balance Sheets***(Dollars in thousands, except per share data)*

	<b>June 30,</b>	<b>September</b>
	<b>2017</b>	<b>30,</b>
	<b>(unaudited)</b>	<b>2016</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 5,123	4,017
Accounts receivable, net	3,285	3,747
Merchandise inventory	92,864	86,330
Prepaid expenses and other current assets	2,226	3,233
Total current assets	103,498	97,327
Property and equipment, net	186,993	178,297
Other assets:		
Deposits and other assets	1,608	971
Goodwill and other intangible assets, net of accumulated amortization of \$388 and \$380, respectively	5,653	5,601
Deferred financing costs, net	41	50
Total other assets	7,302	6,622
Total assets	\$ 297,793	282,246
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 57,489	53,615
Accrued expenses	16,070	12,448
Capital and financing lease obligations, current portion	521	478
Total current liabilities	74,080	66,541

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Long-term liabilities:		
Capital and financing lease obligations, net of current portion	31,510	31,429
Revolving credit facility	27,477	27,428
Deferred income tax liabilities, net	11,478	12,178
Deferred compensation	1,110	757
Deferred rent	10,352	8,809
Leasehold incentives	9,085	8,379
Total long-term liabilities	91,012	88,980
Total liabilities	165,092	155,521
Commitments (Note 6 and 10)		
Stockholders' equity:		
Common stock, \$0.001 par value, 50,000,000 shares authorized, 22,510,279 shares issued at June 30, 2017 and September 30, 2016 and 22,434,931 and 22,452,609 shares outstanding at June 30, 2017 and September 30, 2016, respectively	23	23
Additional paid-in capital	55,873	55,437
Retained earnings	77,610	71,955
Common stock in treasury at cost, 75,348 and 57,670 shares, at June 30, 2017 and September 30, 2016, respectively	(805 )	(690 )
Total stockholders' equity	132,701	126,725
Total liabilities and stockholders' equity	\$ 297,793	282,246

See accompanying notes to unaudited interim consolidated financial statements.



Table of Contents**NATURAL GROCERS BY VITAMIN COTTAGE, INC.****Consolidated Statements of Income****(Unaudited)***(Dollars in thousands, except per share data)*

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Net sales	\$194,709	179,274	570,489	524,455
Cost of goods sold and occupancy costs	141,928	128,344	411,397	373,627
Gross profit	52,781	50,930	159,092	150,828
Store expenses	45,028	40,095	129,271	114,768
Administrative expenses	5,105	4,813	14,947	14,503
Pre-opening and relocation expenses	970	2,007	3,515	4,399
Operating income	1,678	4,015	11,359	17,158
Interest expense	(876)	) (768	) (2,738	) (2,154
Income before income taxes	802	3,247	8,621	15,004
Provision for income taxes	(204)	) (567	) (2,966	) (4,999
Net income	\$598	2,680	5,655	10,005
Net income per common share:				
Basic	\$0.03	0.12	0.25	0.44
Diluted	\$0.03	0.12	0.25	0.44
Weighted average number of shares of common stock outstanding:				
Basic	22,460,058	22,501,044	22,457,328	22,499,229
Diluted	22,469,186	22,506,098	22,465,126	22,505,220

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents**NATURAL GROCERS BY VITAMIN COTTAGE, INC.****Consolidated Statements of Cash Flows****(Unaudited)***(Dollars in thousands)*

	<b>Nine months ended</b>	
	<b>June 30,</b>	
	<b>2017</b>	<b>2016</b>
Operating activities:		
Net income	\$5,655	10,005
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,965	18,617
(Gain) loss on disposal of property and equipment	(21 )	4
Share-based compensation	604	662
Deferred income tax (benefit) expense	(700 )	5,754
Non-cash interest expense	-	10
Changes in operating assets and liabilities		
Decrease (increase) in:		
Accounts receivable, net	462	(17 )
Merchandise inventory	(6,534 )	(11,550 )
Prepaid expenses and other assets	871	(2,409 )
Increase (decrease) in:		
Accounts payable	7,114	3,409
Accrued expenses	3,588	(6,363 )
Deferred compensation	353	330
Deferred rent and leasehold incentives	2,500	2,280
Net cash provided by operating activities	35,857	20,732
Investing activities:		
Acquisition of property and equipment	(36,748 )	(39,302 )
Proceeds from sale of property and equipment, net of commissions of \$80 and zero, respectively	2,585	12
Net cash used in investing activities	(34,163 )	(39,290 )
Financing activities:		
Borrowings under credit facility	224,350	175,062
Repayments under credit facility	(224,300)	(156,235)
Capital and financing lease obligations payments	(352 )	(290 )
Loan fees paid	-	(42 )
Repurchases of common stock	(261 )	(139 )
Payments on withholding tax for vested restricted stock units	(25 )	(10 )
Net cash (used in) provided by financing activities	(588 )	18,346
Net increase (decrease) in cash and cash equivalents	1,106	(212 )

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Cash and cash equivalents, beginning of period	4,017	2,915
Cash and cash equivalents, end of period	\$5,123	2,703
Supplemental disclosures of cash flow information:		
Cash paid for interest on revolving credit facility	\$504	161
Cash paid for interest on capital and financing lease obligations, net of capitalized interest of \$433 and \$469, respectively	2,156	1,897
Income taxes paid	2,534	6,362
Supplemental disclosures of non-cash investing and financing activities:		
Acquisition of property and equipment not yet paid	\$3,594	9,177
Property acquired through capital and financing lease obligations	226	3,343

See accompanying notes to unaudited interim consolidated financial statements.

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**NATURAL GROCERS BY VITAMIN COTTAGE, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements**

**June 30, 2017 and 2016**

**1. Organization**

*Nature of Business*

Natural Grocers by Vitamin Cottage, Inc. (Natural Grocers or the holding company) and its consolidated subsidiaries (collectively, the Company) operate retail stores that specialize in natural and organic groceries and dietary supplements. The Company operates its retail stores under its trademark *Natural Grocers by Vitamin Cottage*®. As of June 30, 2017, the Company operated 140 stores in 19 states. The Company also has a bulk food repackaging facility and distribution center in Golden, Colorado. The Company had 126 stores in 19 states as of September 30, 2016.

**2. Basis of Presentation and Summary of Significant Accounting Policies**

*Consolidated Financial Statements*

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial statements and are in the form prescribed by Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. The information included in this Form 10-Q should be read in conjunction with Item 7 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and notes thereto included in the Form 10-K. The accompanying consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the Company’s financial results. Interim results are not necessarily indicative of results for any other interim period or for a full fiscal year. The Company reports its results of operations on a fiscal year ending September 30.

The accompanying consolidated financial statements include all the accounts of the holding company's wholly owned subsidiaries, Vitamin Cottage Natural Food Markets, Inc. (the operating company) and Vitamin Cottage Two Ltd. Liability Company (VC2). All significant intercompany balances and transactions have been eliminated in consolidation.

The Company has one reporting segment: natural and organic retail stores. Sales from the Company's natural and organic retail stores are derived from sales of the following product categories, which are presented as a percentage of sales for the three and nine months ended June 30, 2017 and 2016, as follows:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Grocery	66.9 %	66.8	66.3	66.4
Dietary supplements	22.0	22.0	22.4	22.3
Other	11.1	11.2	11.3	11.3
	100.0%	100.0	100.0	100.0

*Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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. Management reviews its estimates on an ongoing basis, including those related to lease assumptions, allowances for self-insurance reserves, valuation of inventories, useful lives of property and equipment for depreciation and amortization, valuation allowances for deferred tax assets and litigation based on currently available information. Changes in facts and circumstances may result in revised estimates and actual results could differ from those estimates.

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*Recent Accounting Pronouncements*

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (ASU 2017-04). The amendments in ASU 2017-04 simplify the accounting for goodwill impairment for all entities by requiring impairment charges to be based on the first step in the current two-step impairment test. An impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value should be recognized; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments should be applied on a prospective basis. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017 and is effective for the Company’s first quarter of the fiscal year ending September 30, 2020. The Company is currently evaluating the impact that the adoption of these provisions will have on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting,” Topic 718, “Compensation-Stock Compensation” (ASU 2016-09). ASU 2016-09 includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements, including income tax consequences, forfeitures and classification on the statement of cash flows. The provisions of ASU 2016-09 are effective for the Company’s first quarter of the fiscal year ending September 30, 2018, with early adoption permitted. Currently, the Company does not expect to early adopt the provisions of ASU 2016-09. Based upon current estimates, the Company does not expect the adoption of ASU 2016-09 will have a significant impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases,” Topic 842, “Leases” (ASU 2016-02). ASU No. 2016-02 requires lessees to recognize a right-of-use asset and corresponding lease liability for all leases with terms of more than 12 months. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. ASU 2016-02 also requires certain quantitative and qualitative disclosures. The provisions of ASU 2016-02 should be applied on a modified retrospective basis and are effective for the Company’s first quarter of the fiscal year ending September 30, 2020, with early adoption permitted. The adoption of ASU 2016-02 will result in a material increase to the Company’s consolidated balance sheets for lease liabilities and right-of-use assets. The Company is currently evaluating the other effects the adoption of ASU 2016-02 will have on its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, “Simplifying the Measurement of Inventory,” Topic 330, “Inventory” (ASU 2015-11). The amendments in ASU 2015-11, which apply to inventory that is measured using any method other than the last-in, first-out (LIFO) or retail inventory method, require that entities measure inventory at the lower of cost and net realizable value. The amendments in ASU 2015-11 should be applied on a prospective basis. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016 and interim periods within those years. The provisions of ASU 2015-11 are effective for the Company’s first quarter of the fiscal year ending September 30, 2018. The Company does not expect the adoption of these provisions to have a significant impact on the Company’s consolidated

financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," Topic 606, "Revenue from Contracts with Customers" (ASU 2014-09). ASU 2014-09 provides guidance for revenue recognition and will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled for the transfer of those goods or services. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. In July 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date." The FASB approved the deferral of ASU 2014-09, by extending the new revenue recognition standard's mandatory effective date by one year and permitting public companies to apply the new revenue standard to annual reporting periods beginning after December 15, 2017. However, earlier adoption is permitted only for annual reporting periods beginning after December 15, 2016. The guidance in ASU 2014-09 will be effective for the Company in the first quarter of the fiscal year ending September 30, 2019. The Company is continuing to evaluate the impact that the adoption of ASU 2014-09 will have on its consolidated financial statements. As of the date of this report, the Company has not finalized any estimates of the qualitative impact of the adoption of ASU 2014-09. The Company expects that the adoption of ASU 2014-09 will not have a significant impact on the Company's revenue, which is substantially point of sale product revenue.

### **3. Earnings Per Share**

Basic earnings per share (EPS) is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS reflects the potential dilution that could occur if the Company's granted but unvested restricted stock units (RSUs) were to vest, resulting in the issuance of common stock that would then share in the Company's earnings.

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Presented below are basic and diluted EPS for the three and nine months ended June 30, 2017 and 2016, dollars in thousands, except per share data:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Net income	\$598	2,680	5,655	10,005
Weighted average number of shares of common stock outstanding	22,460,058	22,501,044	22,457,328	22,499,229
Effect of dilutive securities	9,128	5,054	7,798	5,991
Weighted average number of shares of common stock outstanding including effect of dilutive securities	22,469,186	22,506,098	22,465,126	22,505,220
Basic earnings per share	\$0.03	0.12	0.25	0.44
Diluted earnings per share	\$0.03	0.12	0.25	0.44

There were 68,864 non-vested RSUs for each of the three and nine months ended June 30, 2017, respectively, excluded from the calculation of diluted EPS as they are antidilutive. There were 103,795 and 91,828 antidilutive non-vested RSUs for the three and nine months ended June 30, 2016, respectively.

The Company did not declare any dividends in the three or nine months ended June 30, 2017 or 2016.

#### 4. Debt

##### *Credit Facility*

The Company is party to a credit facility (the Credit Facility) pursuant to which the amount available for borrowing is \$45.0 million, including a \$5.0 million sublimit for standby letters of credit. The operating company is the borrower under the Credit Facility and its obligations under the Credit Facility are guaranteed by the holding company and VC2. The Credit Facility is secured by a lien on substantially all of the Company's assets. The Company has the ability to increase the amount available for borrowing under the Credit Facility by an additional amount that may not exceed \$5.0 million if the lenders agree to provide an additional commitment or commitments. The Company has the right to borrow, prepay and re-borrow amounts under the Credit Facility at any time prior to the maturity date. The Credit Facility matures on January 31, 2021.



For floating rate borrowings under the Credit Facility, interest is determined by the lender's administrative agent based on the most recent compliance certificate of the operating company and stated at the base rate less the lender spread based upon certain financial measures. For fixed rate borrowings under the Credit Facility, interest is determined by quoted LIBOR rates for the interest period plus the lender spread based upon certain financial measures. The unused commitment fee is based upon certain financial measures.

The Credit Facility requires compliance with certain customary operational and financial covenants, including a leverage ratio. The Credit Facility also contains certain other customary limitations on the Company's ability to incur additional debt, guarantee other obligations, grant liens on assets and make investments or acquisitions, among other limitations. Additionally, the Credit Facility prohibits the payment of cash dividends, except that so long as no default exists or would arise as a result thereof, the operating company may pay cash dividends to the holding company for various audit, accounting, tax, securities, indemnification, reimbursement, insurance and other reasonable expenses incurred in the ordinary course of business, and for repurchases of shares of common stock in an amount not to exceed \$10.0 million.

The Company had \$27.5 million outstanding under the Credit Facility as of June 30, 2017 and \$27.4 million outstanding under the Credit Facility as of September 30, 2016. As of each of June 30, 2017 and September 30, 2016, the Company had undrawn, issued and outstanding letters of credit of \$1.0 million, which were reserved against the amount available for borrowing under the terms of the Credit Facility. The Company had \$16.5 million available for borrowing under the Credit Facility as of June 30, 2017 and \$16.6 million available for borrowing under the Credit Facility as of September 30, 2016.

#### *Capital and Financing Lease Obligations*

The Company had 17 leases as of June 30, 2017 and 16 leases as of September 30, 2016 that are included in capital and financing lease obligations (see Note 6). The Company does not record rent expense for these capitalized real estate leases; rather rental payments under the capital leases are recognized as a reduction of the capital and financing lease obligation and as interest expense. The interest rate on capital and financing lease obligations is determined at the inception of the lease.

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The Company incurred interest expense of approximately \$0.9 million and \$0.8 million for the three months ended June 30, 2017 and 2016, respectively, and approximately \$2.7 million and \$2.2 million for the nine months ended June 30, 2017 and 2016, respectively. The Company capitalized interest of \$0.2 million for each of the three months ended June 30, 2017 and 2016, and \$0.4 million and \$0.5 million for the nine months ended June 30, 2017 and 2016, respectively.

**5. Shareholders' Equity***Share Repurchases*

On May 5, 2016, the Company's Board of Directors (the Board) authorized a two-year share repurchase program pursuant to which the Company may repurchase up to \$10.0 million in shares of the Company's common stock. Repurchases under the Company's share repurchase program are made from time to time at management's discretion on the open market or through privately negotiated transactions in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended (the Exchange Act), subject to market conditions, applicable legal requirements and other relevant factors. Repurchases of common stock may also be made under a Rule 10b5-1 plan, which would permit common stock to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The share repurchase program does not obligate the Company to purchase any particular amount of common stock and may be suspended, modified or discontinued by the Company without prior notice.

The following table summarizes share repurchase activity for the periods indicated (in thousands, except number of shares acquired and average per share cost):

	<b>Three months ended June 30,</b>		<b>Nine months ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Number of common shares acquired	30,000	10,300	30,000	10,300
Average price per common share acquired (including commissions)	\$8.71	13.46	8.71	13.46
Total cost of common shares acquired	\$261	139	261	139

During the three and nine months ended June 30, 2017, the Company reissued 63 and 12,322 treasury shares, respectively, at a cost of \$0 million and \$0.1 million, respectively, to satisfy the issuance of common stock pursuant to the vesting of certain restricted stock unit awards and the award of common stock grants. During the three and nine months ended June 30, 2016, the Company did not reissue any treasury shares to satisfy the issuance of common stock pursuant to the vesting of certain restricted stock unit awards or the award of common stock grants. At June 30, 2017 and September 30, 2016, the Company held in treasury 75,348 shares and 57,670 shares, respectively, totaling approximately \$0.8 million and \$0.7 million, respectively.

Between July 1, 2017 and July 31, 2017 (the latest practicable date for making the determination), the Company has not repurchased any additional shares of the Company's common stock.

## 6. Lease Commitments

Capital and financing lease obligations as of June 30, 2017 and September 30, 2016, were as follows, dollars in thousands:

	<b>As of June 30, 2017</b>	<b>September 30, 2016</b>
Capital lease finance obligations, due in monthly installments through fiscal year 2032	\$26,750	25,619
Capital lease obligations, due in monthly installments through fiscal year 2041	5,055	5,213
Capital lease finance obligations for assets under construction, due in monthly installments through fiscal year 2032	226	1,075
Total capital and financing lease obligations	32,031	31,907
Less current portion	(521 )	(478 )
Total capital and financing lease obligations, net of current portion	\$31,510	31,429

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On October 7, 2016, the Company consummated a sale-leaseback transaction with an unrelated third party for a store building. Concurrently with the Company's sale of the building, the Company entered into an agreement to lease the building back from the purchaser over an initial lease term of 15 years. The sale resulted in proceeds to the Company of approximately \$2.6 million and a loss to the Company of approximately \$0.5 million. Such loss has been deferred by the Company and will be amortized over the initial lease term. The Company classified the lease as operating and considers the transaction as a normal leaseback with no continuing involvement under the provisions of FASB Accounting Standards Codification Topic 840, "Leases."

**7. Property and Equipment**

The Company had the following property and equipment balances as of June 30, 2017 and September 30, 2016, dollars in thousands:

	Useful lives  (in years)	As of June 30, 2017	September 30, 2016
Construction in process	n/a	\$7,232	6,561
Capitalized real estate leases for build-to-suit stores, including unamortized land of \$617 and \$617, respectively	40	29,548	28,393
Capitalized real estate leases	15	5,735	5,735
Land	n/a	192	192
Buildings	40	16,249	12,546
Land improvements	5– 24	1,141	1,055
Leasehold and building improvements	1– 25	129,126	118,119
Fixtures and equipment	5– 7	115,101	103,415
Computer hardware and software	3– 5	18,864	16,737
		323,188	292,753
Less accumulated depreciation and amortization		(136,195)	(114,456 )
Property and equipment, net		\$186,993	178,297

As of June 30, 2017 and September 30, 2016, construction in process included approximately \$0.2 and \$1.1 million, respectively, related to construction costs for build-to-suit leases in process for which the Company was deemed the owner during the construction period.

Capitalized real estate leases for build-to-suit stores includes the assets for the Company's buildings under capital lease finance obligations, and capitalized real estate leases includes assets for the Company's buildings under capital lease obligations (see Note 6).

Depreciation and amortization expense for the three and nine months ended June 30, 2017 and 2016 is summarized as follows, dollars in thousands:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>June 30,</b>	<b>2016</b>	<b>June 30,</b>	<b>2016</b>
	<b>2017</b>		<b>2017</b>	<b>2016</b>
Depreciation and amortization expense included in cost of goods sold and occupancy costs	\$275	220	792	639
Depreciation and amortization expense included in store expenses	6,871	5,851	20,068	17,084
Depreciation and amortization expense included in administrative expenses	373	309	1,105	894
Total depreciation and amortization expense	\$7,519	6,380	21,965	18,617

Table of Contents**8. Accrued Expenses**

The composition of accrued expenses as of June 30, 2017 and September 30, 2016 is summarized as follows, dollars in thousands:

	<b>As of</b>	
	<b>June</b>	<b>September</b>
	<b>30,</b>	<b>30,</b>
	<b>2017</b>	<b>2016</b>
Payroll and employee-related expenses	\$7,156	4,395
Accrued property, sales and use tax payable	5,215	5,648
Accrued marketing expenses	1,973	567
Deferred revenue related to gift card sales	892	866
Other	834	972
Total accrued expenses	\$16,070	12,448

**9. Related Party Transactions**

The Company has ongoing relationships with related entities as noted below:

*Chalet Properties, LLC:* The Company has five operating leases and one capital lease with Chalet Properties, LLC (Chalet). Chalet is owned by the Company's four non-independent Board members: Kemper Isely, Zephyr Isely, Heather Isely and Elizabeth Isely, and other related family members. Rent paid to Chalet was approximately \$0.3 million for each of the three months ended June 30, 2017 and 2016. Rent paid to Chalet was approximately \$0.9 million for each of the nine months ended June 30, 2017 and 2016.

*Isely Family Land Trust LLC:* The Company has one operating lease with the Isely Family Land Trust LLC (the Land Trust). The Land Trust is owned by the Isely Children's Trust and by the Margaret A. Isely Family Trust. Rent paid to the Land Trust was approximately \$0.1 million for each of the three months ended June 30, 2017 and 2016. Rent paid to the Land Trust was approximately \$0.2 million for each of the nine months ended June 30, 2017 and 2016.

*FTVC LLC:* The Company has one operating lease for a store location with FTVC LLC, which is owned by the Company's four non-independent Board members and other related family members. Rent paid to FTVC LLC was less than \$0.1 million for each of the three months ended June 30, 2017 and 2016. Rent paid to FTVC LLC was less than

\$0.1 million for each of the nine months ended June 30, 2017 and 2016.

## **10. Commitments and Contingencies**

The Company is periodically involved in various legal proceedings that are incidental to the conduct of its business, including but not limited to employment discrimination claims, customer injury claims and investigations. When the potential liability from a matter can be estimated and the loss is considered probable, the Company records the estimated loss. Due to uncertainties related to the resolution of lawsuits, investigations and claims, the ultimate outcome may differ from the estimates. The Company cannot predict with certainty the ultimate resolution of any lawsuits, investigations and claims asserted against it. In management's opinion, based upon the information available at this time, the Company does not believe that the outcome of any currently pending legal proceeding to which the Company is a party will have a material adverse effect on its business, prospects, financial condition, cash flows or results of operations.

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

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with our unaudited consolidated financial statements and notes thereto included elsewhere in this Form 10-Q and with the audited consolidated financial statements and notes thereto in our Form 10-K. This MD&A contains forward-looking statements. Refer to “*Forward-Looking Statements*” at the beginning of this Form 10-Q for an explanation of these types of statements. All references to a “fiscal year” refer to a year beginning on October 1 of the previous year and ending on September 30 of such year (for example, “fiscal year 2017” refers to the fiscal year from October 1, 2016 to September 30, 2017). Summarized numbers included in this section, and corresponding percentage or basis point changes may not sum due to the effects of rounding.

**Company Overview**

We operate natural and organic grocery and dietary supplement stores that are focused on providing high quality products at affordable prices, exceptional customer service, nutrition education and community outreach. We offer a variety of natural and organic groceries and dietary supplements that meet our strict quality standards. We believe we have been at the forefront of the natural and organic foods movement since our founding. We are headquartered in Lakewood, Colorado. As of June 30, 2017, we operated 140 stores in 19 states, including Colorado, Arkansas, Arizona, Idaho, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, Texas, Utah, Washington and Wyoming. We also operate a bulk food repackaging facility and distribution center in Golden, Colorado. The size of our stores varies from 5,000 to 16,000 selling square feet. During the twelve months ended June 30, 2017, our new stores averaged approximately 11,000 selling square feet.

The growth in the organic and natural foods industry and growing consumer interest in health and nutrition have enabled us to continue to open new stores and enter new markets. During the five fiscal years ended September 30, 2016, we increased our store count at a compound annual growth rate of 20.8%. In fiscal year 2016, we opened 23 new stores. During the nine months ended June 30, 2017, we have opened 14 new stores. We do not plan to open any additional new stores during the remainder of fiscal 2017. As of the date of this report, we have signed leases for nine new stores that we plan to open in fiscal years 2018 and beyond. During the nine months ended June 30, 2017, we relocated one store. We relocated one store in July 2017, with no additional relocations planned for the three months ending September 30, 2017.

**Performance Highlights**



Key highlights of our performance for the three and nine months ended June 30, 2017 are discussed briefly below and in further detail throughout this MD&A. Key financial metrics, including, but not limited to, comparable store sales, daily average comparable store sales, mature store sales and daily average mature store sales are defined under the caption “Key Financial Metrics in Our Business,” presented later in this MD&A.

*Net sales.* Net sales were \$194.7 million for the three months ended June 30, 2017, an increase of \$15.4 million, or 8.6%, compared to net sales of \$179.3 million for the three months ended June 30, 2016. Net sales were \$570.5 million for the nine months ended June 30, 2017, an increase of \$46.0 million, or 8.8%, compared to net sales of \$524.5 million for the nine months ended June 30, 2016.

*Comparable store sales.* Comparable store sales for the three months ended June 30, 2017 decreased 0.7% compared to the three months ended June 30, 2016. Comparable store sales for the nine months ended June 30, 2017 decreased 1.0% compared to the nine months ended June 30, 2016.

*Daily average comparable store sales.* Daily average comparable store sales, which removes the effect of one less selling day in the three months ended June 30, 2017 as a result of the shift of the Easter holiday, increased 0.4% and 0.7% for the three months ended June 30, 2017 and 2016, respectively. Daily average comparable store sales, which removes the effect of one less selling day in the nine months ended June 30, 2017 as a result of the occurrence of leap year in fiscal 2016, decreased 0.7% for the nine months ended June 30, 2017 and increased 1.8% for the nine months ended June 30, 2016.

*Mature store sales and daily average mature store sales.* Mature store sales and daily average mature store sales for the three months ended June 30, 2017 decreased 2.0% and 0.9%, respectively, compared to the three months ended June 30, 2016. Mature store sales and daily average mature store sales for the nine months ended June 30, 2017 decreased 2.5% and 2.1%, respectively, compared to the nine months ended June 30, 2016.

*Net income.* Net income was \$0.6 million for the three months ended June 30, 2017, a decrease of \$2.1 million, or 77.7%, compared to net income of \$2.7 million for the three months ended June 30, 2016. Net income was \$5.7 million for the nine months ended June 30, 2017, a decrease of \$4.4 million, or 43.5%, compared to net income of \$10.0 million for the nine months ended June 30, 2016.

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*EBITDA.* Earnings before interest, taxes, depreciation and amortization (EBITDA) was \$9.2 million for the three months ended June 30, 2017, a decrease of \$1.2 million, or 11.5%, compared to \$10.4 million for the three months ended June 30, 2016. EBITDA was \$33.3 million for the nine months ended June 30, 2017, a decrease of \$2.5 million, or 6.9%, compared to \$35.8 million for the nine months ended June 30, 2016. EBITDA is not a measure of financial performance under GAAP. Refer to the “Non-GAAP Financial Measures” section in this MD&A for a definition of EBITDA and a reconciliation of net income to EBITDA.

*Liquidity.* As of June 30, 2017, cash and cash equivalents was \$5.1 million, and there was \$16.5 million available for borrowing under our Credit Facility, net of undrawn, issued and outstanding letters of credit of \$1.0 million.

*New store growth.* We opened five new stores during the three months ended June 30, 2017 and 14 new stores during the nine months ended June 30, 2017. We operated a total of 140 stores as of June 30, 2017. We do not plan to open any additional new stores during the remainder of fiscal 2017, which would result in an annual new store growth rate of 11.1% for fiscal year 2017.

*Store Relocations.* We did not relocate any stores during the three months ended June 30, 2017. We relocated one store during the nine months ended June 30, 2017. We relocated one store in July 2017, with no additional relocations planned for the three months ending September 30, 2017.

**Industry Trends and Economics**

We have identified the following recent trends and factors that have impacted and may continue to impact our results of operations and financial condition:

*Impact of broader economic trends.* The grocery industry and our sales are affected by general economic conditions, including, but not limited to, consumer spending, macroeconomic trends, the level of disposable consumer income, consumer debt, interest rates, the price of commodities, the political environment and consumer confidence. In this regard, we believe our financial results for the three and nine months ended June 30, 2017 continue to reflect economic pressures in several of the markets we serve due to the lingering impact of depressed oil and natural gas prices and general economic uncertainty.

*Opportunities in the growing natural and organic grocery and dietary supplements industry.* Our industry, which includes organic and natural foods and dietary supplements, continues to experience growth driven primarily by increased public interest in health and nutrition. Capitalizing on this opportunity, we continue to open new stores and enter new markets. As we open new stores, our results of operations have been and may continue to be materially adversely affected based on the timing and number of new stores we open, their initial sales and new lease costs. The length of time it takes for a new store to become profitable can vary depending on a number of factors, including location, competition, a new market versus an existing market, the strength of store management and general economic conditions. Once a new store is open, it typically grows at a faster rate than mature stores for several years.

Mature stores are stores that have been open for any part of five fiscal years or longer.

As we expand across the United States and enter markets where consumers may not be as familiar with our brand, we seek to secure prime real estate locations for our stores to establish greater visibility with consumers in those markets. This strategy has resulted in higher lease costs, and we anticipate these increased costs will continue for the foreseeable future. Our financial results for the three and nine months ended June 30, 2017 reflect the effects of these factors, and we anticipate future periods will be similarly impacted.

Our performance is also impacted by trends regarding natural and organic products, dietary supplements and at-home meal delivery and preparation. Consumer preferences towards dietary supplements or natural and organic food products might shift as a result of, among other things, economic conditions, food safety perceptions, changing consumer choices and the cost of these products. Our store offerings consist of natural and organic products and dietary supplements. A change in consumer preferences away from our offerings, including those resulting from reductions or changes in our offerings, would have a material adverse effect on our business. Additionally, negative publicity regarding the safety of dietary supplements, product recalls or new or upgraded regulatory standards may adversely affect demand for the products we sell and could result in lower consumer traffic, sales and results of operations.

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*Increased Competition.* The grocery and dietary supplement retail business is a large, fragmented and highly competitive industry, with few barriers to entry. Our competition varies by market and includes conventional supermarkets such as Kroger and Safeway, mass or discount retailers such as Wal-Mart and Target, natural and gourmet markets such as Whole Foods and The Fresh Market, foreign-based discount retailers such as Aldi and Lidl, specialty food retailers such as Sprouts and Trader Joe's, warehouse clubs such as Sam's Club and Costco, independent health food stores, dietary supplement retailers, drug stores, farmers' markets, food co-ops, online retailers such as Amazon, meal delivery services and multi-level marketers. Competition in the grocery industry is likely to intensify, and shopping dynamics may shift, as a result of, among other things, Amazon's agreement to acquire Whole Foods, which was announced on June 16, 2017, the plans of Aldi and Lidl to expand their presence in the United States and the expanding availability of grocery ordering, pick-up and delivery options. These businesses compete with us on the basis of price, selection, quality, customer service, shopping experience, ease of ordering and delivery or any combination of these or other factors. They also compete with us for products and locations. In addition, some of our competitors are expanding to offer a greater range of natural and organic foods. We believe our commitment to carrying only carefully vetted, affordably priced and high-quality natural and organic products and dietary supplements, as well as our focus on providing nutritional education, differentiate us in the industry and provide a competitive advantage. In addition, we face internally generated competition when we open new stores in markets we already serve.

## **Outlook**

We believe there are several key factors that have contributed to our success and will enable us to increase our comparable store sales and continue to profitably expand. These factors include a loyal customer base, growing consumer interest in nutrition and wellness, a differentiated shopping experience that focuses on customer service, nutrition education and a shopper friendly retail environment, and our focus on high quality, affordable natural and organic groceries and dietary supplements.

We plan for the foreseeable future to continue opening new stores and entering new markets. The rate of new store growth in the foreseeable future is expected to moderate compared to recent years, depending on economic and business conditions and other factors. During the past few years, we have expanded our infrastructure to enable us to support our continued unit growth. This has included implementing our enterprise resource planning system, hiring key personnel, developing efficient new store opening construction and operations processes and relocating and expanding our bulk food repackaging facility and distribution center. During fiscal year 2015, we redesigned our website ([www.naturalgrocers.com](http://www.naturalgrocers.com)) to enhance functionality, create a more engaging user experience and increase its reach and effectiveness. In addition, in fiscal year 2015 we introduced the *{N}power*<sup>®</sup> customer appreciation program at all of our stores, which we believe has enhanced customer loyalty and increased customer engagement levels. In fiscal year 2017, we have implemented an improved job applicant tracking and onboarding system, which we expect will help us to better attract, identify and hire new employees.

We believe there are opportunities for us to continue to expand our store base while also expanding profitability and increasing comparable store sales. However, future sales growth, including comparable store sales, and our

profitability could vary due to increasing competitive conditions in the natural and organic grocery and dietary supplement industry and regional and general economic conditions. In this regard, our comparable store sales declined during the nine months ended June 30, 2017 compared to the prior year period as a result of the impact of increased competition in the natural and organic retail sector, internally generated competition due to our opening new stores in existing markets and economic pressures in several of the markets we serve due to the general economic uncertainty and the lingering impact of depressed oil and natural gas prices.

As we continue to expand our store base, we believe there are opportunities for increased leverage in costs, such as administrative expenses, as well as increased economies of scale in sourcing products. However, due to our commitment to providing high-quality products at affordable prices and increased competition, such sourcing economies and efficiencies at our bulk food repacking facility and distribution center may not be reflected in our gross margin in the near term. In addition, our ability to leverage costs may be limited due to the fixed nature of our rent obligations and related occupancy expenses.

Our operating results may be affected by the above-described factors as well as a variety of other internal and external factors and trends described more fully in Item 1A – “Risk Factors” in our Form 10-K and Item 1A – “Risk Factors” in this Form 10-Q.

### **Key Financial Metrics in Our Business**

In assessing our performance, we consider a variety of performance and financial measures. The key measures are as follows:

#### *Net sales*

Our net sales are comprised of gross sales net of discounts, in-house coupons and returns and allowances. In comparing net sales between periods we monitor the following:

*Change in comparable store sales.* We begin to include sales from a store in comparable store sales on the first day of the thirteenth full month following the store’s opening. We monitor the percentage change in comparable store sales by comparing sales from all stores in our comparable store base for a reporting period against sales from the same stores for the same number of operating months in the comparable reporting period of the prior year. When a store that is included in comparable store sales is remodeled or relocated, we continue to consider sales from that store to be comparable store sales. Our comparable store sales data may not be presented on the same basis as our competitors. We use the term “new stores” to refer to stores that have been open for less than thirteen months.



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*Change in daily average comparable store sales.* Daily average comparable store sales are comparable store sales divided by the number of selling days in each period. We use this metric to remove the effect of differences in the number of selling days we are open during the comparable periods (for example, as a result of leap years or the Easter holiday shift between quarters).

*Change in mature store sales.* We begin to include sales from a store in mature store sales after the store has been open for any part of five fiscal years (for example, our mature stores for fiscal year 2017 are stores that opened during or before fiscal year 2012). We monitor the percentage change in mature store sales by comparing sales from all stores in our mature store base for a reporting period against sales from the same stores for the same number of operating months in the comparable reporting period of the prior year. When a store that is included in mature store sales is remodeled or relocated, we continue to consider sales from that store to be mature store sales. Our mature store sales data may not be presented on the same basis as our competitors.

*Change in daily average mature store sales.* Daily average mature store sales are mature store sales divided by the number of selling days in each period. We use this metric to remove the effect of differences in the number of selling days during the comparable periods (for example, as a result of leap years or the Easter holiday shift between quarters).

*Transaction count.* Transaction count represents the number of transactions reported at our stores during the period and includes transactions that are voided, return transactions and exchange transactions.

*Average transaction size.* Average transaction size, or basket size, is calculated by dividing net sales by transaction count for a given time period. We use this metric to track the trends in average dollars spent in our stores per customer transaction.

*Cost of goods sold and occupancy costs*

Our cost of goods sold and occupancy costs include the cost of inventory sold during the period (net of discounts and allowances), shipping and handling costs, distribution and supply chain costs (including the costs of our bulk food repackaging facility), buying costs, shrink expense and store occupancy costs. Store occupancy costs include rent, common area maintenance and real estate taxes. Depreciation expense included in cost of goods sold relates to depreciation of assets directly used at our bulk food repackaging facility. The components of our cost of goods sold and occupancy costs may not be identical to those of our competitors, and as a result, our cost of goods sold and occupancy costs data included in this Form 10-Q may not be identical to those of our competitors, and may not be comparable to similar data made available by our competitors. Occupancy costs as a percentage of sales typically decrease as new stores mature and increase sales. Rent payments for leases classified as capital and financing lease obligations are not recorded in cost of goods sold and occupancy costs. Rather, these rent payments are recognized as a reduction of the related obligations and as interest expense. Additionally, depreciation expense related to the capitalized asset is recorded in store expenses.

*Gross profit and gross margin*

Gross profit is equal to our net sales less our cost of goods sold and occupancy costs. Gross margin is gross profit as a percentage of net sales. Gross margin is impacted by changes in retail prices, product costs, occupancy costs and the mix of products sold, as well as the rate at which we open new stores.

*Store expenses*

Store expenses consist of store level expenses, such as salary and benefits, share-based compensation, supplies, utilities, depreciation, advertising, bank credit card charges and other related costs associated with marketing, operations and purchasing support. Depreciation expense included in store expenses relates to depreciation for assets directly used at the stores, including depreciation on capitalized real estate leases, land improvements, leasehold improvements, fixtures and equipment and computer hardware and software. Additionally, store expenses include any gain or loss recorded on the disposal of fixed assets, primarily related to store relocations. The largest component of store expenses is labor-related expenses. Labor-related expenses as a percentage of sales tend to be higher at new stores compared to comparable stores, as new stores require a certain level of staffing in order to maintain adequate levels of customer service combined with lower sales. As new stores increase their sales, labor-related expenses as a percentage of sales typically decrease.



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*Administrative expenses*

Administrative expenses consist of home office-related expenses, such as salary and benefits, share-based compensation, office supplies, hardware and software expenses, depreciation and amortization expense, occupancy costs (including rent, common area maintenance, real estate taxes and utilities), professional services expenses, expenses associated with our Board, expenses related to compliance with the requirements of the Sarbanes-Oxley Act of 2002, as amended (Sarbanes-Oxley), and other general and administrative expenses. Depreciation expense included in administrative expenses relates to depreciation for assets directly used at the home office including depreciation on land improvements, leasehold improvements, fixtures and equipment and computer hardware and software.

*Pre-opening and relocation expenses*

Pre-opening and relocation expenses may include rent expense, salaries, advertising, supplies and other miscellaneous costs incurred prior to the store opening. Rent expense is generally incurred from one to four months prior to a store's opening date for store leases classified as operating. For store leases classified as capital or financing leases, no pre-opening rent expense is recognized. Other pre-opening and relocation expenses are generally incurred in the 60 days prior to the store opening. Certain advertising and promotional costs associated with opening a new store may be incurred both before and after the store opens. All pre-opening and relocation costs are expensed as incurred.

*Operating income*

Operating income consists of gross profit less store expenses, administrative expenses and pre-opening and relocation expenses. Operating income can be impacted by a number of factors, including the timing of new store openings and store relocations, whether or not a store lease is classified as an operating, capital or financing lease, as well as fluctuations in store expenses and administrative expenses. The amount of time it takes for new stores to become profitable can vary depending on a number of factors, including location, competition, a new market versus an existing market and the strength of store management.

*Interest expense*

Interest expense consists of the interest associated with capital and financing lease obligations and interest we incur on outstanding indebtedness, all net of capitalized interest.



Table of Contents**Results of Operations**

The following table presents key components of our results of operations expressed as a percentage of net sales for the periods presented:

	<b>Three months ended June 30, 2017</b>		<b>Nine months ended June 30, 2016</b>	
<b>Statements of Income Data:*</b>				
Net sales	100.0%	100.0	100.0	100.0
Cost of goods sold and occupancy costs	72.9	71.6	72.1	71.2
Gross profit	27.1	28.4	27.9	28.8
Store expenses	23.1	22.4	22.7	21.9
Administrative expenses	2.6	2.7	2.6	2.8
Pre-opening and relocation expenses	0.5	1.1	0.6	0.8
Operating income	0.9	2.2	2.0	3.3
Interest expense	(0.4 )	(0.4 )	(0.5 )	(0.4 )
Income before income taxes	0.4	1.8	1.5	2.9
Provision for income taxes	(0.1 )	(0.3 )	(0.5 )	(1.0 )
Net income	0.3 %	1.5	1.0	1.9

*\*Figures may not sum due to rounding.*

Number of stores at end of period	140	118	140	118
Number of stores opened during the period	5	6	14	15
Total store unit count increase over prior 12 months	18.6 %	19.2	18.6	19.2
Change in comparable store sales	(0.7 )	1.8	(1.0 )	2.1
Change in daily average comparable store sales	0.4	0.7	(0.7 )	1.8
Change in mature store sales	(2.0 )	(0.2 )	(2.5 )	(0.4 )
Change in daily average mature store sales	(0.9 )	(1.3 )	(2.1 )	(0.8 )

***Three months ended June 30, 2017 compared to the three months ended June 30, 2016***

The following table summarizes our results of operations and other operating data for the periods presented, dollars in thousands:

	Three months ended		Change In		
	June 30, 2017	2016	Dollars	Percent	
<b>Statements of Income Data:</b>					
Net sales	\$ 194,709	179,274	15,435	8.6	%
Cost of goods sold and occupancy costs	141,928	128,344	13,584	10.6	
Gross profit	52,781	50,930	1,851	3.6	
Store expenses	45,028	40,095	4,933	12.3	
Administrative expenses	5,105	4,813	292	6.1	
Pre-opening and relocation expenses	970	2,007	(1,037 )	(51.7 )	
Operating income	1,678	4,015	(2,337 )	(58.2 )	
Interest expense	(876 )	(768 )	(108 )	14.1	
Income before income taxes	802	3,247	(2,445 )	(75.3 )	
Provision for income taxes	(204 )	(567 )	363	(64.0 )	
Net income	\$ 598	2,680	(2,082 )	(77.7 )	

*Net sales*

Net sales increased \$15.4 million, or 8.6%, to \$194.7 million for the three months ended June 30, 2017 compared to \$179.3 million for the three months ended June 30, 2016, primarily due to a \$16.7 million increase in sales from new stores, partially offset by a \$1.3 million decrease in comparable store sales, which was due to the loss of a selling day as a result of the shift of the Easter holiday in the three months ended June 30, 2017. Daily average comparable store sales increased 0.4% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The daily average comparable store sales increase resulted from a 0.3% decrease in daily average transaction count and a 0.7% increase in average transaction size. We believe the increase in daily average comparable store sales reflects the success of certain of our recent marketing initiatives and our operational focus on sales initiatives. Comparable store average transaction size was \$35.06 for the three months ended June 30, 2017. Daily average mature store sales decreased 0.9% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016.

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*Gross profit*

Gross profit increased \$1.9 million, or 3.6%, to \$52.8 million for the three months ended June 30, 2017 compared to \$50.9 million for the three months ended June 30, 2016, primarily driven by an increase in the number of comparable stores, partially offset by lower gross profit at non-comparable stores. Gross margin decreased to 27.1% for the three months ended June 30, 2017 from 28.4% for the three months ended June 30, 2016. Gross margin during the three months ended June 30, 2017 was negatively impacted by an increase in occupancy costs as a percentage of sales, primarily due to the addition of new stores, and the loss of one selling day during the quarter. We have experienced higher average lease expenses at newer format stores opened since fiscal year 2012 and at relocated stores. The increase in occupancy cost as a percentage of sales also reflects the decrease in average mature store sales combined with the fixed nature of our rent obligations and related occupancy expenses. Additionally, gross margin was negatively impacted by decreases in product margin reflecting a shift in product category mix towards grocery and increased promotional activity, partially offset by favorable shrink expense trends, all as a percentage of sales.

We had 17 and 15 store leases that were classified as capital and financing lease obligations for the three months ended June 30, 2017 and 2016, respectively. If these leases had qualified as operating leases, the straight-line rent expense would have been included in occupancy costs, and our costs of goods sold and occupancy costs as a percentage of sales during the three months ended June 30, 2017 and 2016, would have been approximately 55 basis points higher for each of the periods.

*Store expenses*

Store expenses increased \$4.9 million, or 12.3%, to \$45.0 million for the three months ended June 30, 2017 compared to \$40.1 million for the three months ended June 30, 2016. Store expenses as a percentage of sales were 23.1% and 22.4% for the three months ended June 30, 2017 and 2016, respectively. The increase in store expenses as a percentage of sales was primarily due to increases in depreciation, utilities, marketing and other store expenses, partially offset by slightly lower labor-related expenses.

*Administrative expenses*

Administrative expenses increased \$0.3 million, or 6.1%, to \$5.1 million for the three months ended June 30, 2017 compared to \$4.8 million for the three months ended June 30, 2016. The increase in administrative expenses was primarily due to an increase in expenses related to compliance with the requirements of Sarbanes-Oxley. Administrative expenses as a percentage of sales were 2.6% and 2.7% for the three months ended June 30, 2017 and 2016, respectively.

*Pre-opening and relocation expenses*

Pre-opening and relocation expenses decreased \$1.0 million, or 51.7%, to \$1.0 million for the three months ended June 30, 2017 compared to \$2.0 million for the three months ended June 30, 2016, due to the impact of the number and timing of new store openings and relocations. We opened five new stores during the three months ended June 30, 2017 and opened six new stores and relocated one existing store during the three months ended June 30, 2016. Pre-opening and relocation expenses as a percentage of sales were 0.5% and 1.1% for the three months ended June 30, 2017 and 2016, respectively.

*Interest expense*

Interest expense, net of capitalized interest, increased \$0.1 million, or 14.1%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The increase in interest expense is primarily due to higher average borrowings under our Credit Facility and an increase in the number of capital leases during the three months ended June 30, 2017. If the capital and financing lease obligations had qualified as operating leases, interest expense as a percent of sales for the three months ended June 30, 2017 and 2016 would have been approximately 35 basis points lower than as reported in each period.

*Income taxes*

Our effective income tax rate for the three months ended June 30, 2017 and 2016 was 25.5% and 17.5%, respectively. The increase in the effective income tax rate for the three months ended June 30, 2017 was primarily the result of a lower effective income tax rate for the three months ended June 30, 2016 due to higher federal and state tax credits in the provision for that period.

Table of Contents*Net income*

Net income was \$0.6 million, or \$0.03 diluted earnings per share, for the three months ended June 30, 2017 compared to \$2.7 million, or \$0.12 diluted earnings per share, for the three months ended June 30, 2016.

*Nine months ended June 30, 2017 compared to the nine months ended June 30, 2016*

The following table summarizes our results of operations and other operating data for the periods presented, dollars in thousands:

	<b>Nine months ended</b>		<b>Change In</b>		
	<b>June 30, 2017</b>	<b>2016</b>	<b>Dollars</b>	<b>Percent</b>	
<b>Statements of Income Data:</b>					
Net sales	\$570,489	524,455	46,034	8.8	%
Cost of goods sold and occupancy costs	411,397	373,627	37,770	10.1	
Gross profit	159,092	150,828	8,264	5.5	
Store expenses	129,271	114,768	14,503	12.6	
Administrative expenses	14,947	14,503	444	3.1	
Pre-opening and relocation expenses	3,515	4,399	(884 )	(20.1 )	
Operating income	11,359	17,158	(5,799 )	(33.8 )	
Interest expense	(2,738 )	(2,154 )	(584 )	(27.1 )	
Income before income taxes	8,621	15,004	(6,383 )	(42.5 )	
Provision for income taxes	(2,966 )	(4,999 )	2,033	(40.7 )	
Net income	\$5,655	10,005	(4,350 )	(43.5 )	

*Net sales*

Net sales increased \$46.0 million, or 8.8%, to \$570.5 million for the nine months ended June 30, 2017 compared to \$524.5 million for the nine months ended June 30, 2016, primarily due to a \$51.4 million increase in sales from new stores, partially offset by a \$5.4 million decrease in comparable store sales. The decline in comparable store sales during the nine months ended June 30, 2017 was due to the impact of increased competition in the natural and organic sector, internally generated competition due to opening new stores in our existing markets and economic pressures in several of the markets we serve due to the lingering impact of depressed oil and natural gas prices and general economic uncertainty and, to a lesser extent, the loss of one selling day due to the occurrence of leap year in fiscal

year 2016. Daily average comparable store sales decreased 0.7% for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016. The daily average comparable store sales decrease resulted from a 0.8% decrease in daily average transaction count and a 0.2% increase in average transaction size. Comparable store average transaction size was \$35.65 for the nine months ended June 30, 2017. Daily average mature store sales decreased 2.1% for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016.

*Gross profit*

Gross profit increased \$8.3 million, or 5.5%, to \$159.1 million for the nine months ended June 30, 2017 compared to \$150.8 million for the nine months ended June 30, 2016, primarily driven by an increase in the number of comparable stores and a slight improvement in product gross margin. Gross margin decreased to 27.9% for the nine months ended June 30, 2017 from 28.8% for the nine months ended June 30, 2016. Gross margin during the nine months ended June 30, 2017 was negatively impacted by an increase in occupancy costs as a percentage of sales, primarily due to the higher average lease expenses experienced at newer format stores opened since fiscal year 2012 and at relocated stores. The increase in occupancy cost as a percentage of sales also reflects the decrease in average mature store sales combined with the fixed nature of our rent obligations and related occupancy expenses.

We had 17 and 15 store leases that were classified as capital and financing lease obligations for the nine months ended June 30, 2017 and 2016, respectively. If these leases had qualified as operating leases, the straight-line rent expense would have been included in occupancy costs, and our costs of goods sold and occupancy costs as a percentage of sales during the nine months ended June 30, 2017 and 2016, would have been approximately 55 basis points higher for each of the periods.



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*Store expenses*

Store expenses increased \$14.5 million, or 12.6%, to \$129.3 million for the nine months ended June 30, 2017 compared to \$114.8 million for the nine months ended June 30, 2016. Store expenses as a percentage of sales were 22.7% and 21.9% for the nine months ended June 30, 2017 and 2016, respectively. The increase in store expenses as a percentage of sales was primarily due to increases in labor-related expenses, depreciation, utilities and other store expenses partially offset by lower marketing expenses.

*Administrative expenses*

Administrative expenses increased \$0.4 million, or 3.1%, to \$14.9 million for the nine months ended June 30, 2017 compared to \$14.5 million for the nine months ended June 30, 2016. The increase in administrative expenses was due to increased public company costs related to compliance with the requirements of Sarbanes-Oxley. Administrative expenses as a percentage of sales were 2.6% and 2.8% for the nine months ended June 30, 2017 and 2016, respectively.

*Pre-opening and relocation expenses*

Pre-opening and relocation expenses decreased \$0.9 million, or 20.1%, to \$3.5 million for the nine months ended June 30, 2017 compared to \$4.4 million for the nine months ended June 30, 2016, due to the impact of the number and timing of new store openings and relocations. We opened 14 new stores and relocated one store during the nine months ended June 30, 2017 and opened 15 new stores, relocated three stores and remodeled one store during the nine months ended June 30, 2016. Pre-opening and relocation expenses as a percentage of sales were 0.6% and 0.8% for the nine months ended June 30, 2017 and 2016, respectively.

*Interest expense*

Interest expense, net of capitalized interest, increased \$0.6 million, or 27.1%, for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016. The increase in interest expense is primarily due to higher average borrowings under our Credit Facility and an increase in the number of capital leases during the nine months ended June 30, 2017. If the capital and financing lease obligations had qualified as operating leases, interest expense as a percent of sales for the nine months ended June 30, 2017 and 2016 would have been approximately 35 basis points lower than as reported in each period.

*Income taxes*

Our effective income tax rate for the nine months ended June 30, 2017 and 2016 was 34.4% and 33.3%, respectively. The increase in the effective income tax rate for the nine months ended June 30, 2017 was primarily due to the favorable return to provision adjustment for the nine months ended June 30, 2016.

*Net income*

Net income was \$5.7 million, or \$0.25 diluted earnings per share, for the nine months ended June 30, 2017 compared to \$10.0 million, or \$0.44 diluted earnings per share, for the nine months ended June 30, 2016.

*Non-GAAP financial measures**EBITDA*

EBITDA is not a measure of financial performance under GAAP. We define EBITDA as net income before interest expense, provision for income taxes and depreciation and amortization. The following table reconciles net income to EBITDA for the periods presented, dollars in thousands:

	<b>Three months ended June 30,</b>		<b>Nine months ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Net income	\$598	2,680	5,655	10,005
Interest expense	876	768	2,738	2,154
Provision for income taxes	204	567	2,966	4,999
Depreciation and amortization	7,519	6,380	21,965	18,617
EBITDA	\$9,197	10,395	33,324	35,775

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EBITDA decreased 11.5% to \$9.2 million in the three months ended June 30, 2017 compared to \$10.4 million for the three months ended June 30, 2016. EBITDA decreased 6.9% to \$33.3 million in the nine months ended June 30, 2017 compared to \$35.8 million for the nine months ended June 30, 2016. EBITDA as a percent of sales was 4.7% and 5.8% in the three months ended June 30, 2017 and 2016, respectively. EBITDA as a percent of sales was 5.8% and 6.8% in the nine months ended June 30, 2017 and 2016, respectively. Stores with leases that are classified as capital and financing lease obligations, rather than being reflected as operating leases, increased EBITDA as a percentage of sales by approximately 55 basis points for each of the three months ended June 30, 2017 and 2016, and by approximately 55 basis points for each of the nine months ended June 30, 2017 and 2016, due to the impact on cost of goods sold and occupancy costs as discussed above, as well as occupancy costs that would have been included in pre-opening expenses prior to the stores' opening dates if these leases had been accounted for as operating leases.

Management believes that some investors' understanding of our performance is enhanced by including EBITDA, a non-GAAP financial measure. We believe EBITDA provides additional information about: (i) our operating performance, because it assists us in comparing the operating performance of our stores on a consistent basis, as it removes the impact of non-cash depreciation and amortization expense as well as items not directly resulting from our core operations such as interest expense and income taxes and (ii) our performance and the effectiveness of our operational strategies. Additionally, EBITDA is a component of a measure in our financial covenants under our Credit Facility. Further, our incentive compensation plan bases incentive compensation payments on EBITDA.

Furthermore, management believes some investors use EBITDA as a supplemental measure to evaluate the overall operating performance of companies in our industry. Management believes that some investors' understanding of our performance is enhanced by including this non-GAAP financial measure as a reasonable basis for comparing our ongoing results of operations. By providing this non-GAAP financial measure, together with a reconciliation from net income, we believe we are enhancing analysts' and investors' understanding of our business and our results of operations, as well as assisting analysts and investors in evaluating how well we are executing our strategic initiatives.

Our competitors may define EBITDA differently, and as a result, our measure of EBITDA may not be directly comparable to those of other companies. Items excluded from EBITDA are significant components in understanding and assessing financial performance. EBITDA is a supplemental measure of operating performance that does not represent, and should not be considered in isolation or as an alternative to, or substitute for, net income or other financial statement data presented in the consolidated financial statements as indicators of financial performance. EBITDA has limitations as an analytical tool, and should not be considered in isolation, or as an alternative to, or as a substitute for, analysis of our results as reported under GAAP. Some of the limitations are:

EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;

EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

EBITDA does not reflect any impact for straight-line rent expense for leases classified as capital and financing lease obligations;

EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments on our debt;

EBITDA does not reflect our tax expense or the cash requirements to pay our taxes; and

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future and EBITDA does not reflect any cash requirements for such replacements.

Due to these limitations, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA as supplemental information.

### **Liquidity and Capital Resources**

Our ongoing primary sources of liquidity are cash generated from operations, current balances of cash and cash equivalents and borrowings under the Credit Facility. Our primary uses of cash are for purchases of inventory, operating expenses, capital expenditures predominantly in connection with opening, relocating and remodeling stores, interest and principal payments for outstanding indebtedness and corporate taxes. As of June 30, 2017, we had \$5.1 million in cash and cash equivalents, as well as \$16.5 million available for borrowing under our Credit Facility.

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On May 5, 2016, our Board authorized a two-year share repurchase program pursuant to which the Company may expend up to \$10.0 million to repurchase shares of the Company's common stock. During the three and nine months ended June 30, 2017, we repurchased 30,000 shares of our common stock for approximately \$0.3 million (an average price of \$8.71 per share) under the share repurchase program. We expect funding for any future share repurchases will come from operating cash flow, excess cash and/or borrowings under our Credit Facility. The timing and the amount of shares repurchased will be dictated by our capital needs and stock market conditions.

We plan to continue to open new stores, which may require us to borrow additional amounts under the Credit Facility. We plan to spend approximately \$2.2 million to \$4.2 million on capital expenditures during the remainder of fiscal year 2017 primarily in connection with one store relocation and the acquisition of property, plant and equipment not previously paid for. We believe that cash and cash equivalents, together with the cash generated from operations and the borrowing availability under our Credit Facility, will be sufficient to meet our working capital needs and planned capital expenditures, including capital expenditures related to new store needs for at least the next twelve months. Our working capital 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.

We anticipate that our new stores will require, on average, an upfront capital investment of approximately \$2.2 million per store consisting of capital expenditures of approximately \$1.7 million, net of tenant allowances, initial inventory of approximately \$0.3 million, net of payables, and pre-opening expenses of approximately \$0.2 million.

Following is a summary of our operating, investing and financing activities for the periods presented, dollars in thousands:

	<b>Nine months ended</b>	
	<b>June 30, 2017</b>	<b>2016</b>
Net cash provided by operating activities	\$35,857	20,732
Net cash used in investing activities	(34,163)	(39,290)
Net cash (used in) provided by financing activities	(588 )	18,346
Net increase (decrease) in cash and cash equivalents	1,106	(212 )
Cash and cash equivalents, beginning of period	4,017	2,915
Cash and cash equivalents, end of period	\$5,123	2,703

*Operating Activities*

Net cash provided by operating activities consists primarily of net income adjusted for non-cash items, including depreciation and amortization and changes in deferred taxes, and the effect of working capital changes. Net cash provided by operating activities increased \$15.1 million, or 72.9%, to \$35.9 million for the nine months ended June 30, 2017 compared to \$20.7 million for the nine months ended June 30, 2016. The increase in cash provided by operating activities was primarily due to a change in working capital driven by accrued expenses, inventory and other purchases, partially offset by a decrease in net income, as adjusted for non-cash items such as depreciation and amortization resulting from the addition of new stores and deferred tax expense. Our working capital requirements for inventory will likely increase as we continue to open new stores. To effectively manage increases in inventory, we continue to focus on optimizing average store inventory.

### *Investing Activities*

Net cash used in investing activities decreased \$5.1 million, or 13%, to \$34.2 million for the nine months ended June 30, 2017 compared to \$39.3 million for the nine months ended June 30, 2016. This decrease was due to \$2.6 million proceeds, net of commissions, related to the sale/leaseback of one store building and fewer new and relocated stores during the nine months ended June 30, 2017

### *Financing Activities*

Cash (used in) provided by financing activities consists primarily of borrowings and repayments under our Credit Facility and payments of capital and financing lease obligations. Cash used in financing activities was \$0.6 million for the nine months ended June 30, 2017 compared to cash provided by financing activities of \$18.3 million for the nine months ended June 30, 2016. The change was primarily the result of lower net incremental borrowings on the Credit Facility for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016.

### **Credit Facility**

The amount available for borrowing under the Credit Facility is \$45.0 million, including a \$5.0 million sublimit for standby letters of credit. The operating company is the borrower under the Credit Facility and its obligations under the Credit Facility are guaranteed by the holding company and VC2. The Credit Facility is secured by a lien on substantially all of the Company's assets. The Company has the ability to increase the amount available for borrowing under the Credit Facility by an additional amount that may not exceed \$5.0 million if the lenders agree to provide an additional commitment or commitments. The Company has the right to borrow, prepay and re-borrow amounts under the Credit Facility at any time prior to the maturity date. The Credit Facility matures on January 31, 2021.



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For floating rate borrowings under the Credit Facility, interest is determined by the lender's administrative agent based on the most recent compliance certificate of the operating company and stated at the base rate less the lender spread based upon certain financial measures. For fixed rate borrowings under the Credit Facility, interest is determined by quoted LIBOR rates for the interest period plus the lender spread based upon certain financial measures. The unused commitment fee is based upon certain financial measures.

The Credit Facility requires compliance with certain customary operational and financial covenants, including a leverage ratio. The Credit Facility also contains certain other customary limitations on the Company's ability to incur additional debt, guarantee other obligations, grant liens on assets and make investments or acquisitions, among other limitations. Additionally, the Credit Facility prohibits the payment of cash dividends, except that so long as no default exists or would arise as a result thereof, the operating company may pay cash dividends to the holding company for various audit, accounting, tax, securities, indemnification, reimbursement, insurance and other reasonable expenses incurred in the ordinary course of business, and for repurchases of shares of common stock in an amount not to exceed \$10.0 million.

We had \$27.5 million outstanding under the Credit Facility as of June 30, 2017 and \$27.4 million outstanding under the Credit Facility as of September 30, 2016. As of each of June 30, 2017 and September 30, 2016, we had undrawn, issued and outstanding letters of credit of \$1.0 million, which were reserved against the amount available for borrowing under the terms of the Credit Facility. We had \$16.5 million available for borrowing under the Credit Facility as of June 30, 2017. As of June 30, 2017 and September 30, 2016, the Company was in compliance with the debt covenants under the Credit Facility.

## **Share Repurchases**

Certain information about the Company's share repurchases is set forth under the heading "Share Repurchases" in Note 5 of Notes to Unaudited Interim Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q and in Part II, Item 2 of this Form 10-Q.

## **Contractual Obligations**

The following table summarizes our contractual obligations as of June 30, 2017, dollars in thousands:

### **Payments Due by Period**



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	<b>Total</b>	<b>Less than 1 year</b>	<b>1 - 3 years</b>	<b>3 - 5 years</b>	<b>More than 5 years</b>
Operating leases <sup>(1)</sup>	\$507,720	39,267	79,632	76,179	312,642
Capital and financing lease obligations, including principal and interest payments <sup>(2)</sup>	48,055	4,068	8,383	8,465	27,139
Contractual obligations for construction related activities <sup>(3)</sup>	-	-	-	-	-
Debt obligations <sup>(4)</sup>	27,477	-	-	27,477	-
Interest payments <sup>(5)</sup>	1,741	426	853	462	-
	\$584,993	43,761	88,868	112,583	339,781

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<sup>(1)</sup> Represents the minimum lease payments due under our operating leases, excluding annual common area maintenance, insurance and taxes related to our operating lease obligations.

<sup>(2)</sup> Represents the payments due under our capital and financing lease obligations for 17 stores, of which 16 were open as of June 30, 2017. We do not record rent expense for these capital leases, but rather rental payments under the capital leases are recognized as a reduction of the capital and financing lease obligations and interest expense.

<sup>(3)</sup> Contractual obligations for construction-related activities include future payments to general contractors that are legally binding as of June 30, 2017 and relate to new store construction, relocations and remodels.

<sup>(4)</sup> Represents the outstanding balance on our Credit Facility as of June 30, 2017. For purposes of this table, the outstanding balance is considered outstanding until January 31, 2021, which is the maturity date of the Credit Facility.

<sup>(5)</sup> In order to estimate future interest payments during the remaining term of our Credit Facility, current amounts were considered outstanding until January 31, 2021, which is the maturity date of the Credit Facility.

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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**

As of June 30, 2017, our off-balance sheet arrangements consisted of operating leases and the undrawn portion of our Credit Facility. The majority of our stores and facilities are leased. We own buildings in which four of our stores are located; those buildings are located on land that is leased pursuant to a ground lease. As of June 30, 2017, 17 store leases were classified as capital and financing lease obligations, and the remaining leases were classified as operating leases in our consolidated financial statements. We have no other off-balance sheet arrangements that have had, or are reasonably likely to have, a material effect on our consolidated financial statements or financial condition.

**Recent Accounting Pronouncements**

See Note 2 to the consolidated financial statements included in this Form 10-Q.

**Critical Accounting Policies**

The preparation of our consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures of contingent assets and liabilities. Actual amounts may differ from these estimates. We base our estimates on historical experience and on various other assumptions and factors that we believe to be reasonable under the circumstances. We evaluate our accounting policies and resulting estimates on an ongoing basis to make adjustments we consider appropriate under the facts and circumstances.

Critical accounting policies that affect our more significant judgments and estimates used in the preparation of our financial statements include accounting for income taxes, accounting for impairment of long-lived assets and accounting for leases, which are discussed in more detail under the caption “Critical Accounting Policies” under Item 7 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in our Form 10-K.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

To a limited extent, we are exposed to interest rate changes with respect to our Credit Facility. We do not use financial instruments for trading or other speculative purposes. There have been no material changes regarding our market risk position from the information provided under Item 7A – “Quantitative and Qualitative Disclosures about Market Risk” in our Form 10-K.

### **Item 4. Controls and Procedures**

#### *Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our principal executive officers and principal financial and accounting officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act, as of the end of the period covered by this Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on that evaluation, our principal executive officers and principal financial and accounting officer concluded that our disclosure controls and procedures were effective as of June 30, 2017.

#### *Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. Other Information**

**Item 1. Legal Proceedings**

We are periodically involved in various legal proceedings, including discrimination and other employment-related claims, customer personal injury claims, investigations and other proceedings arising in the ordinary course of business. When the potential liability from a matter can be estimated and the loss is considered probable, we record the estimated loss. Due to uncertainties related to the resolution of lawsuits, investigations and claims, the ultimate outcome may differ from our estimates. We cannot predict with certainty the ultimate resolution of any lawsuits, investigations and claims asserted against us. In management's opinion, based upon the information available at this time, we do not believe that the outcome of any currently pending legal proceeding to which we are a party will have a material adverse effect on our business, prospects, financial condition, cash flows or results of operations.

**Item 1A. Risk Factors**

The risk factor set forth below updates those set forth in the Form 10-K.

*If the United States were to withdraw from or materially modify NAFTA or certain other international trade agreements, or if tariffs on the foreign-sourced goods that we sell were to increase, or if a border adjustment tax were enacted, our business, financial condition and results of operations could be materially adversely affected.*

Certain of the produce and other products that we sell at our stores are purchased, or contain ingredients sourced, from suppliers in Mexico, Canada and other foreign countries. President Donald Trump has expressed antipathy towards certain existing international trade agreements, including the North American Free Trade Agreement (NAFTA), and made comments suggesting that he supports significantly increasing tariffs on goods imported into the United States. As of the date of this Form 10-Q, it remains unclear what actions, if any, President Trump will take with respect to NAFTA, other international trade agreements and tariffs on goods imported into the United States. If the United States were to withdraw from or materially modify NAFTA or other international trade agreements to which it is a party, or if tariffs were raised on the foreign-sourced goods that we sell, such goods may no longer be available at a commercially attractive price or at all, which in turn could have a material adverse effect on our business, financial condition and results of operations.

In addition, President Trump and some members of Congress have expressed support for or interest in the enactment of a “border adjustment” tax, pursuant to which companies would not be allowed to deduct the cost of imports from their revenue to determine their taxable income. As of the date of this Form 10-Q, it remains unclear whether a border adjustment tax will be formally proposed or enacted. The enactment of a border adjustment tax could have the net effect of increasing the cost of the foreign-sourced goods that we sell and make it more difficult for us to sell such goods at a commercially attractive price or at all, which in turn could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table presents information with respect to purchases of the Company's common stock during the three months ended June 30, 2017 by the Company or any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Exchange Act.

Period	Total Number of Shares Purchased	Average Price Paid Per Share <sup>(1)</sup>	Total Number of Shares	Approximate Dollar Value of
			Purchased as Part of Publicly Announced Plans or Programs <sup>(2)</sup>	Shares that May Yet Be Purchased Under the Plans or Programs ( <i>in thousands</i> )
April 1, 2017 to April 30, 2017	—	\$ —	67,970	\$ 9,171
May 1, 2017 to May 31, 2017	—	—	67,970	9,171
June 1, 2017 to June 30, 2017	30,000	8.71	97,970	8,910
Total	30,000	\$ 8.71	97,970	\$ 8,910

(1) Average price paid per share includes commissions paid.

(2) On May 5, 2016, our Board authorized a two-year share repurchase program pursuant to which the Company may repurchase up to \$10.0 million in shares of the Company's common stock.

**Item 6. Exhibits**

See Exhibit Index.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized on August 3, 2017.

Natural Grocers by Vitamin Cottage, Inc.

By: /s/ KEMPER ISELY  
Kemper Isely, Co-President  
*(Principal Executive Officer)*

By: /s/ SANDRA BUFFA  
Sandra Buffa, Chief Financial Officer  
*(Principal Financial and Accounting Officer)*

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**EXHIBIT INDEX**

Exhibit

Number	Description
31.1	Certification of Kemper Isely, a Principal Executive Officer Required Under Section 302(a) of the Sarbanes-Oxley Act of 2002
31.2	Certification of Zephyr Isely, a Principal Executive Officer Required Under Section 302(a) of the Sarbanes-Oxley Act of 2002
31.3	Certification of Sandra Buffa, Principal Financial Officer Required Under Section 302(a) of the Sarbanes-Oxley Act of 2002
32.1†	Certification of Principal Executive Officers and Principal Financial Officer Required Under 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Natural Grocers by Vitamin Cottage, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of June 30, 2017 (unaudited) and September 30, 2016, (ii) Consolidated Statements of Income for the three and nine months ended June 30, 2017 and 2016 (unaudited), (iii) Consolidated Statements of Cash Flows for the nine months ended June 30, 2017 and 2016 (unaudited) and (iv) Notes to Unaudited Interim Consolidated Financial Statements.

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† The certifications attached as Exhibit 32.1 that accompany this Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Natural Grocers by Vitamin Cottage, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-Q, irrespective of any general incorporation language contained in such filing.