Natural Grocers by Vitamin Cottage, Inc.
Form 10-K
December 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2014

COMMISSION FILE NUMBER: 001-35608

Natural Grocers by Vitamin Cottage, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**45-5034161**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

12612 West Alameda Parkway

Lakewood, Colorado 80228

(Address of principal executive offices)

(303) 986-4600

(Registrants telephone number, including area code)

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

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

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

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

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer	Accelerated filer
Non—accelerated filer (Do not check if a smaller reporting company)	Smaller Reporting Company

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

Based on the closing sales price on March 31, 2014, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was $392,305,227.

The number of shares of the registrant's common stock, $0.001 par value, outstanding as of December 8, 2014 was 22,487,600.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this report, to the extent not set forth herein, is incorporated by reference from the Registrant's definitive Proxy Statement for the 2015 Annual Meeting of the Stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after September 30, 2014.

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Natural Grocers by Vitamin Cottage, Inc.

Annual Report on Form 10-K

For the Fiscal Year Ended September 30, 2014

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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 report on Form 10-K 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 report on Form 10-K, including in the sections entitled "Business," "Risk Factors," and "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 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," "potential," "predict," "project," "future" and si phrases to identify forward-looking statements in this report on Form 10-K.

The forward-looking statements contained in this report on Form 10-K 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 described in "Risk Factors." 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 report on Form 10-K 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 to the Securities and Exchange Commission, on our website or otherwise.

PART I

Item 1. Business.

General

Natural Grocers is an expanding specialty retailer of natural and organic groceries and dietary supplements. We focus on providing high-quality products at affordable prices, exceptional customer service, nutrition education and community outreach. We strive to generate long-term relationships with our customers based on transparency and trust by:

- selling only natural and organic groceries and dietary supplements that meet our strict quality guidelines—we do not approve for sale grocery products that are known to contain artificial colors, flavors, preservatives or sweeteners or partially hydrogenated or hydrogenated oils;

- utilizing an efficient and flexible small-store format to offer affordable prices and a shopper-friendly retail environment; and

- enhancing our customers' shopping experience by providing free science-based nutrition education to help our customers make well-informed health and nutrition choices.

Our History and Founding Principles

Our founders, Margaret and Philip Isely, were early proponents of the connection between health and the use of natural and organic products and dietary supplements. In the mid-1950's, Margaret transformed her health and the health of her family by applying concepts and principles she learned from books on nutrition. This inspired the Iselys to provide the same type of nutrition education to their community. The Iselys initially started by lending books on nutrition and providing samples of whole grain bread door-to-door in Golden, Colorado and ultimately concluded they could develop a viable business that would also improve their customers' well-being. Over time, they fostered relationships through nutrition education and began taking orders for dietary supplements, whole grain bread and unprocessed foods. As their customers gained more knowledge about nutrition, they were empowered to make changes to their diets with the objective of supporting their health. Using this model as the foundation for their business, the Iselys opened their first store in 1958, which they later moved to a modest cottage.

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We are committed to maintaining the following founding principles, which have helped foster our growth:

Nutrition Education. We provide nutrition education in the communities we serve. Empowering our customers and our employees to take charge of their lives and their health is the foundation upon which our business is built.

Quality. Every product on our shelves must go through a rigorous screening and approval process. Our mission includes providing the highest quality groceries and supplements, Natural Grocers branded products and only United States Department of Agriculture (USDA) certified organic, fresh produce at the best prices in the industry.

Every Day Affordable Price. We work hard to secure the best possible prices on all of our customers' favorite natural and organic foods and supplements. We believe everyone should be able to afford to help take care of their health by buying high quality natural and organic products.

Community. From free nutrition education lectures, to bag-free checkouts, to sourcing local products, to our donation program, we work hard to serve the communities that help shape our world.

Employees. Our employees make our company great. We work hard to ensure that our employees are able to live a healthy, balanced lifestyle. We support them with free nutrition education programs, good pay and excellent benefits.

In 1998, the second generation of the family, including Kemper Isely, Zephyr Isely, Heather Isely and Elizabeth Isely, purchased our predecessor and the *Vitamin Cottage*® trademark and assumed control of the business. Since then, we have grown our store count from 11 stores in Colorado to 87 stores in 14 states as of September 30, 2014. We have also implemented numerous organizational and operational improvements that have enhanced our ability to scale our operations. We believe that by staying true to our founding principles, we have been able to continue to attract new customers, extend our geographic reach and further solidify our competitive position.

Our Markets

We operate within the natural products retail industry, which is a subset of the United States grocery industry and the dietary supplement business. This industry includes conventional, natural, gourmet and specialty food markets, mass and discount retailers, warehouse clubs, independent health food stores, dietary supplement retailers, drug stores, farmers markets, food co-ops, mail order and online retailers and multi-level marketers. Industry-wide sales of natural and organic foods and dietary supplements have experienced meaningful growth over the past several years, and we believe that growth will continue for the foreseeable future.

We believe the growth in sales of natural and organic foods and dietary supplements continues to be driven by numerous factors, including:

- greater consumer focus on high-quality nutritional products;
- an increased awareness of the importance of good nutrition to long-term wellness;
- an aging United States population seeking to support healthy aging;
- heightened consumer awareness about the importance of food quality and a desire to avoid pesticide residues, growth hormones, artificial ingredients and genetically engineered ingredients in foods;
- growing consumer concerns over the use of harmful chemical additives in body care and household cleaning supplies;
- well-established natural and organic brands, which generate additional industry awareness and credibility with consumers; and
- the growth in the number of consumers with unique dietary requirements as a result of allergies, chemical sensitivities, auto-immune disorders and other conditions.

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Our Competitive Strengths

We believe we are well-positioned to capitalize on favorable natural and organic grocery and dietary supplement industry dynamics as a result of the following competitive strengths:

Strict focus on high-quality natural and organic grocery products and dietary supplements. We offer high-quality products and brands, including an extensive selection of widely-recognized natural and organic food, dietary supplements, body care products, pet care products and books. We offer our customers an average of approximately 20,700 Stock Keeping Units (SKUs) of natural and organic products per comparable store (stores open for 13 months or longer), including an average of approximately 6,700 SKUs of dietary supplements. We believe our broad product offering enables our customers to shop our stores for substantially all of their grocery and dietary supplement purchases. In our grocery departments, we only sell USDA certified organic produce and do not approve for sale grocery products that are known to contain artificial colors, flavors, preservatives or sweeteners or partially hydrogenated or hydrogenated oils. Consistent with this strategy, our product selection does not include items that do not meet our strict quality guidelines. Our store managers enhance our robust product offering by customizing their stores' selections to address the preferences of local customers. All products undergo a stringent review process to ensure the products we sell meet our strict quality guidelines, which we believe helps us generate long-term relationships with our customers based on transparency and trust.

Engaging customer service experience based on education and empowerment. We strive to offer consistently exceptional customer service in a shopper-friendly environment, which we believe creates a differentiated shopping experience, enhances customer loyalty and generates repeat visits from our clientele. A key aspect of our customer service model is to provide free nutrition education to our customers. We believe this focus provides an engaging retail experience while also empowering our customers to make informed decisions about their health. We offer our science-based nutrition education through our trained employees, *Health Hotline*® newsletter and sales flyer, community out-reach programs, one-on-one nutrition health coaching, nutrition classes and cooking demonstrations. Our commitment to nutrition education and customer empowerment is emphasized throughout our entire organization, from executive management to store employees. Every store also maintains a Nutritional Health Coach position. The Nutritional Health Coach is responsible for training our store employees and educating our customers about nutrition in accordance with applicable local, state and federal regulations. Each Nutritional Health Coach must have earned a degree or certificate in nutrition or a related field from an accredited school, complete continuing education in nutrition, and be thoroughly committed to fulfilling our mission. Substantially all of our Nutritional Health Coaches are full-time employees. We believe our Nutritional Health Coach position represents a key element of our customer service model.

Scalable operations and replicable, cost-effective store model. We believe our scalable operating structure, attractive new store model, flexible real estate strategy and disciplined approach to new store development allow us to maximize store performance and continue to grow our store base. Our store model has been successful in highly competitive markets and has supported significant growth outside of our original Colorado geography. We believe our supply chain and infrastructure are scalable and will accommodate significant growth based on the ability of our primary distribution relationships to effectively service our planned store locations. Our investments in overhead and information technology infrastructure, including purchasing, receiving, inventory, point of sale, warehousing, distribution, accounting, reporting and financial systems support this growth. To further support the scalability of our operations, we substantially completed the implementation of a human resources information and learning management system (HRIS) in fiscal year 2014. In addition, we have established effective site selection guidelines, as well as scalable procedures, to enable us to open a new store within approximately nine months from the time of lease execution. Our limited offering of prepared foods also reduces real estate costs, labor costs and perishable inventory shrink and allows us to quickly leverage our new store opening costs.

Experienced and committed team with proven track record. Our executive management team has an average of 36 years of experience in the natural grocery industry, while our entire management team has an average of over 29 years of relevant experience. Since the second generation of the Isely family assumed control of the business in 1998, we have grown our store count from 11 to 87 stores as of September 30, 2014 by remaining dedicated to our founding principles. Over their tenure, members of our executive management team have been instrumental in establishing a successful, scalable operating model, generating consistently strong financial results and developing an effective site selection and store opening process. The depth of our management experience extends beyond our home office. As of September 30, 2014, 38% of our store managers at comparable stores have tenures of over four years with us, and our store and department managers at these stores have average tenures of over three years with us. In addition, we have a track record of promoting store management personnel from within. We believe our management's experience at all levels will allow us to continue to grow our store base while maintaining operational excellence by driving efficiencies in store and back room operations, managing inventory levels and focusing on exceptional customer service.

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Our Growth Strategies

We are pursuing several strategies to continue our profitable growth, including:

Expand our store base. We intend to continue expanding our store base through new store openings in existing markets, as well as penetrating new markets, by leveraging our core competencies of site selection and efficient store openings. Based upon our operating experience and research conducted for us by customer analytics firm The Buxton Company, we believe the entire United States market can support over 1,100 Natural Grocers stores, including over 200 additional Natural Grocers stores in the 16 states in which we currently operate or have signed leases. In the fiscal years 2014 and 2013, we opened 15 and 13 new stores, respectively, and we plan to open 18 new stores in fiscal year 2015, four of which we have opened during the first quarter of fiscal year 2015 prior to filing this report on Form 10-K. We intend to target new store openings at or above our current levels over the near term.

Current store locations, signed leases and new store locations.

*Includes signed leases for stores to be opened subsequent to fiscal year 2014: two leases in Kansas, one lease in Arizona, one lease in Arkansas and one lease in Colorado.

Increase sales from existing customers. We have achieved positive comparable store sales growth for over 49 consecutive quarters. In order to increase our average ticket and the number of customer transactions, we plan to continue offering an engaging customer experience by providing science-based nutrition education and a differentiated merchandising strategy that delivers affordable, high-quality natural and organic grocery products and dietary supplements. We also plan to continue to utilize targeted marketing efforts to reach our existing customers, which we anticipate will drive customer transactions and convert occasional, single-category customers into core, multi-category customers.

Grow our customer base. We plan to continue building our brand awareness, which we anticipate will grow our customer base. We are currently reviewing our marketing communications strategy, collateral marketing materials and digital engagement platform (including our website, *www.naturalgrocers.com*) with the objective of increasing their reach and effectiveness. We believe offering nutrition education has historically been one of our most effective marketing strategies for reaching new customers and increasing the demand for natural and organic groceries and dietary supplements in our markets. To maximize the impact of our Nutritional Health Coaches, we have recently increased their focus on relationship-building opportunities in our communities and with our customers. This initiative includes hosting additional educational cooking events, lectures and classes in our stores. Additionally, we seek to attract new customers by enhancing their nutrition knowledge through printed and digital versions of our broad range of educational resources, including the distribution of our *Health Hotline* newsletter and sales flyer, and via the internet and social media. In addition to offering nutrition education, we intend to attract new customers with our every day affordable prices and to build community awareness through our support of local vendors and charities.

Improve operating margins. We expect to continue to improve our operating margins as we benefit from investments we have made or are making in fixed overhead and information technology, including the implementation of our enterprise resource planning (ERP) system in fiscal year 2010 and the implementation of the HRIS in fiscal year 2014. We anticipate these investments will support our long-term growth strategy with only a modest amount of additional capital. We expect to achieve greater economies of scale through sourcing and distribution as we add more stores. In addition, to achieve additional operating margin expansion, we intend to further optimize performance, maintain appropriate store labor levels and effectively manage product selection and pricing.

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Our Stores

Our stores offer a comprehensive selection of natural and organic groceries and dietary supplements in a smaller-store format that aims to provide a convenient, easily shopped and relaxed environment for our customers. Our store design emphasizes a clutter-free, organized feel, a quiet ambience accented with warm lighting and the absence of aromas from meat and seafood counters present in many of our competitors' stores. We believe our core customers consider us a destination stop for their natural and organic products and dietary supplements.

Our Store Format. Our stores range from 5,000 to 16,000 selling square feet, and average approximately 10,000 selling square feet. In fiscal year 2014, our 15 new stores averaged approximately 11,000 selling square feet. Approximately one quarter of our stores' selling square footage is dedicated to dietary supplements. Some of our stores also include a dedicated community room available for public gathering, a demonstration kitchen for cooking education and/or lecture space. Our comparable stores sell an average of approximately 20,700 SKUs of natural and organic products per store, including an average of approximately 6,700 SKUs of dietary supplements.

The following diagram depicts a typical new store layout:

Site Selection. Our real estate strategy is adaptable to a variety of market conditions. When selecting locations for new stores, we use analytical models, based on research provided by The Buxton Company and our extensive experience, to identify promising store locations. We typically locate new stores in prime locations which offer easy customer access and high visibility. Many of our stores are near other supermarkets or gourmet food retailers, and we complement their conventional product offerings with high-quality, affordable natural and organic groceries and dietary supplements in an efficient and convenient retail setting. Our site selection model incorporates factors such as target demographics, community characteristics, nearby retail activity and other measures in determining viable new store locations and is based on first-hand observation of the community's characteristics surrounding each site. We have a team of employees dedicated to opening new stores efficiently and quickly, typically within approximately nine months from the time of lease execution.

Store Level Economics. Since January 1, 2005, opening new stores has required an average upfront capital investment of approximately $2.1 million. We anticipate that our fiscal year 2015 new stores will require an average upfront capital investment of approximately $2.2 million, 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. We are targeting approximately four years to recoup our initial net cash investments and expect to achieve approximately 35% cash-on-cash returns by the end of the fifth year following the opening.

Individual new store investment levels and the performance of new store locations may differ widely from originally targeted levels and from store-to-store due to a variety of factors, and these differences may be material. In particular, investments in individual stores, store-level sales, profit margins, payback periods and cash-on-cash return levels are impacted by a range of risks and uncertainties beyond our control, including those described under the caption "Risk Factors."

Our Focus on Nutrition Education

Nutrition education is one of our founding principles and is a primary focus for all employees. We believe our emphasis on science-based nutrition education differentiates us from our competitors and creates a unique shopping experience for our customers.

Our Nutritional Health Coaches are a core element of our nutrition education program. Every store has a full-time Nutritional Health Coach position to educate customers and train employees on nutrition. Nutritional Health Coaches must have earned a degree or certificate in nutrition or a related field from an accredited school, complete continuing education in nutrition, and be thoroughly committed to fulfilling our mission. To educate and empower customers to make informed nutrition choices, our Nutritional Health Coaches are available for complimentary one-on-one nutrition health coaching sessions. Each Nutritional Health Coach is also responsible for various relationship-building opportunities in our communities and with our customers, including educational activities such as nutrition classes, lectures, seminars, health fairs and store tours. We have recently increased the Nutritional Health Coaches' focus on hosting cooking events (at our stores with demonstration kitchens) and have increased the number of in-store educational events they conduct. Additionally, our Nutritional Health Coaches are an onsite resource for nutrition training and education for our employees. Each Nutritional Health Coach trains our employees on using a compliant educational approach to customer service without attempting to diagnose or treat. We believe our Nutritional Heath Coach position is a competitive differentiator and represents a key element of our customer service model.

Our training and education programs are supplemented by outside experts, online materials and printed handouts. We also use our *Health Hotline* to educate our customers. The *Health Hotline* is a newsletter and sales flyer which is published eight times per year and includes in-depth articles on health and nutrition, along with a selection of sale items. We are currently redesigning our website to enhance functionality and create a more engaging user experience, including readily accessible additional nutritional education information and resources. We are currently reviewing our marketing communications strategy, collateral marketing materials and digital engagement platform (including our *www.naturalgrocers.com* website) with the objective of increasing their reach and effectiveness.

Our Products

Product Selection Guidelines. We have a set of strict quality guidelines covering all products we sell. For example:

- we do not approve for sale food known to contain artificial colors, flavors, preservatives or sweeteners or partially hydrogenated or hydrogenated oils, regardless of the proportion of its natural or organic ingredients;

we only sell USDA certified organic produce;

we only sell meats naturally raised without antibiotics or hormone treatments and that were not fed animal by-products; and

we do not sell wine, beer, liquor or tobacco.

Our product review team analyzes all new products and approves them for sale based on ingredients, price and uniqueness within the current product set. We actively research new products in the marketplace via our product vendors, private label manufacturers, scientific findings, customer requests and general trends in popular media. Our stores are able to fully merchandise all departments by providing an extensive assortment of natural and organic products. We do not believe we need to sell conventional products to fill our selection, increase our margins or draw in more customers.

What We Sell. We operate both a full-service natural and organic grocery store and a dietary supplement store within a single retail location. The following is a breakdown of our sales mix for the year ended September 30, 2014:

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The products in our stores include:

Grocery. We offer a broad selection of natural and organic grocery products with an emphasis on minimally processed and single ingredient products that are not known to contain artificial colors, flavors, preservatives or sweeteners or partially hydrogenated or hydrogenated oils. Additionally, we carry a wide variety of products associated with special diets such as gluten free, vegetarian and non-dairy. Our grocery products include:

Produce. We sell only USDA certified organic produce and source from local, organic producers whenever feasible. Our selection varies based on seasonal availability, and we offer a variety of organic produce offerings that are not typically found at conventional food retailers.

Bulk Food and Private Label Products. We sell a wide selection of private label products, including nuts, water, pasta, dried fruits, grains, granolas, honey, agave nectar, herbs, spices and teas. We also sell peanut and almond butters, freshly ground in-store under the Natural Grocers brand.

Dry, Frozen and Canned Groceries. We offer a wide variety of natural and organic dry, frozen and canned groceries, including cereals, soups, baby foods, frozen entrees and snack items. We offer a broad selection of natural chocolate bars, and energy, protein and food bars.

Meats and Seafood. We only offer naturally-raised or organic meat products. The meat products we offer come from animals that have never been treated with antibiotics or hormones or fed animal by-products. Additionally, we only buy from companies we believe employ humane animal-raising practices. Our seafood items are generally frozen at the time of processing and sold from our freezer section, thereby ensuring freshness and reducing food spoilage and safety issues.

Dairy Products and Dairy Substitutes. We offer a broad selection of natural and organic dairy products such as milk, eggs, cheeses, yogurts and beverages, as well as non-dairy substitutes made from almonds, coconuts, rice and soy. During fiscal year 2014, we updated our dairy standards, and as a result, plan by April 2015 to sell only pasture-raised, non-confinement dairy products.

Prepared Foods. Our stores have a convenient selection of refrigerated prepared fresh food items, including salads, sandwiches, salsa, humus and wraps. The size of this offering varies by location.

Bread and Baked Goods. We receive regular deliveries of a wide selection of bakery products for our bakery section, which includes an extensive selection of gluten-free items.

Beverages. We offer a wide variety of beverages containing natural and organic ingredients. We also offer low-cost, self-serve filtered drinking water that is dispensed into one-gallon or larger containers provided by our customers.

Dietary Supplements. Our dietary supplement department primarily sells name-brand supplements, as well as a line of private label dietary supplements. The department is carefully organized to help both employees and customers find products efficiently. We generally offer several different formulations and potencies for each type of product in order to meet our customers' varying needs.

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Other.

Body Care. We offer a full range of cosmetics, skin care, hair care, fragrance and personal care products containing natural and organic ingredients. Our body care offerings range from bargain-priced basics to high-end formulations.

Pet Care. We offer a full line of natural pet care and food products that comply with our human food guidelines.

Household and General Merchandise. Our offerings include sustainable, hypo-allergenic and fragrance-free household products, including cleaning supplies, paper products, dish and laundry soap and other common household products, including diapers.

Books and Handouts. We stock approximately 400 titles in each store's book department. Titles cover various approaches to diet, lifestyle and health. Additionally, we offer hundreds of handouts on various health topics and dietary supplements to our customers free of charge.

Quality Assurance. We endeavor to ensure the quality of the products we sell. We work with reputable suppliers we believe are compliant with established regulatory and industry guidelines. Our purchasing department requires a complete supplier and product profile as part of the approval process. Our dietary supplement suppliers must follow Food and Drug Administration (FDA) current good manufacturing practices supported by quality assurance testing for both the base ingredients and the finished product. We expect our suppliers to comply with industry best practices for food safety.

Many of our suppliers are inspected and certified under the USDA National Organic Program, voluntary industry associations, and other third party auditing programs with regard to additional ingredients, manufacturing and handling standards. Each Natural Grocers store is certified as an organic handler and processor by an accredited USDA certifier in the calendar year after it opens, and annually thereafter. We operate all of our stores in compliance with National Organic Program standards, which require segregation of organic and conventional products, restricted use of certain substances for cleaning and pest control and rigorous recordkeeping, among other requirements.

Our Pricing Strategy

We have an every day affordable pricing strategy with an *EDAP - Every Day Affordable Price*SM on many products, while also providing special sale pricing on hundreds of additional items. We believe our every day affordable pricing strategy allows our customers to shop our stores on a regular basis for their groceries and dietary supplements.

Our pricing strategies include the following:

- every day affordable pricing throughout our stores;
- heavily advertised *Health Hotline* deals supported by manufacturer participation;
- in-store specials generally lasting for one month and not advertised outside the store;
- managers' specials, such as clearance, overstock, short-dated or promotional incentives; and
- specials on seasonally harvested produce.

As we continue to expand our store base, we believe there are opportunities for increased leverage in fixed costs, such as administrative expenses, as well as increased economies of scale in sourcing products. We strive to keep our product, operating and general and administrative costs low, which allows us to continue to offer attractive pricing for our customers.

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Our Store Operations

Store Hours. In order to provide better customer service and to aid in expanding our customer base, our store hours in select markets were extended during the fourth quarter of fiscal year 2014, and have been extended during the first quarter of fiscal year 2015 at all our remaining stores. Our stores are open seven days a week.

Store Management and Staffing. Our typical store staffing includes a manager and assistant manager, with department managers in each of the dietary supplement, grocery, dairy and frozen, produce, body care and receiving departments, as well as several non-management employees. Each store manager is responsible for monthly store profit and loss, including labor, merchandising and inventory costs. We also employ regional managers to oversee all store operations for regions consisting of approximately 13 stores.

To ensure a high level of service, all employees receive training and guidance on customer service skills, product attributes and nutrition education. Employees are carefully trained and evaluated based on a requirement that they present nutrition information in an appropriate and legally compliant educational context while interacting with customers. Additionally, store employees are cross-trained in various functions, including cashier duties, stocking and receiving product.

Every store also maintains a Nutritional Health Coach position. The Nutritional Health Coach is responsible for training our store employees and educating our customers in accordance with applicable local, state and federal regulations. Each Nutritional Health Coach must have earned a degree or certificate in nutrition or a related field from an accredited school, complete continuing education in nutrition, and be thoroughly committed to fulfilling our mission. Substantially all of our Nutritional Health Coaches are full-time employees.

Bulk Food Repackaging Facility and Distribution Center. Our 107,000 square foot bulk food repackaging facility and distribution center is in Golden, Colorado. The facility handles several different operational functions, including distribution of a limited number of grocery and dietary supplement lines. The facility also houses our private label bulk foods repackaging lines. The distribution center maintains a small fleet of commercial delivery trucks for use within Colorado.

Inventory. We use a robust merchandise management and perpetual inventory system that values goods at moving average cost. We manage shelf stock based on weeks-on-hand relative to sales, resupply time and minimum economic order quantity.

Sourcing and Vendors. We source from approximately 1,100 suppliers, and offer over 2,800 brands. These suppliers range from small mom-and-pop businesses to multi-national conglomerates. As of September 30, 2014, we purchased approximately 81% of the goods we sell from our top 20 suppliers.

We contract with third-party manufacturers to produce groceries and dietary supplements under our private labels, which include the Natural Grocers and *Vitamin Cottage* brands. We have longstanding relationships with our suppliers, and we require disclosure from them regarding quality, freshness, potency and safety data information. Our bulk food private label products are packaged by us in pre-packed sealed bags to help prevent contamination while in transit and in our stores. Unlike most of our competitors, most of our private label nuts, trail mix and flours are refrigerated in our warehouse and stores to maintain freshness.

For the year ended September 30, 2014, approximately 48% of our total purchases were from United Natural Foods Inc. (UNFI). In addition, approximately 8% of our purchases were from Albert's Organics, a subsidiary of UNFI that distributes fresh produce and meat. We maintain good relations with UNFI and believe we have adequate alternative supply methods, including self-distribution.

Our Employees

Commitment to our employees is one of our five founding principles. Employees are eligible for health, long-term disability, vision and dental insurance coverage, as well as Company paid short-term disability and life insurance benefits, after they meet eligibility requirements. Additionally, our employees are offered a 401(k) retirement savings plan with discretionary contribution matching opportunities. We believe we pay above average retail wages, and all employees earn an additional $0.75 per hour, up to $30 a week, in "Vitamin Bucks" which can be used to purchase products in our stores. It is important to us that our employees live a healthy, balanced lifestyle, and we believe the Vitamin Bucks incentive provides an additional resource for our employees to purchase natural and organic products. This further offers our employees the opportunity to become more familiar with our products, which we believe improves the customer service our employees are able to provide. We believe these and other factors result in higher retention rates and encourage our employees to appreciate our culture, which helps them better promote our brand.

All employees are eligible to participate in our discretionary incentive compensation plan after 90 days of employment for management level employees and after one year of employment for non-management level employees. At our stores, the criteria for incentive compensation include meeting sales projections, sales to labor hour goals and cost of goods sold metrics, which help align all store employees with both corporate and store-level financial goals. We have an established set of standard operating procedures, which includes hiring and human resource policies, training practices and operational instruction manuals. This allows each store to operate with strict accountability and still maintain independence to respond to its unique circumstances.

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As of September 30, 2014, we employed 2,004 full-time and 342 part-time (less than 30 hours per week) employees, including 182 employees at our home office. None of our employees is subject to a collective bargaining agreement. We believe we have good relations with our employees.

Our Customers

The growth in the natural and organic grocery and dietary supplement industries and growing consumer interest in health and nutrition have led to an increase in our core customer base. We believe the demands for affordable, nutritious food and dietary supplements are shared attributes of our core customers, regardless of their socio-economic status. Additionally, we believe our core customers prefer a retail store environment that offers carefully selected natural and organic products and dietary supplements. Our customers tend to be interested in health and nutrition, and expect our store employees to be highly knowledgeable about these topics and related products.

An analysis of our *Health Hotline* subscriber list indicates that our customers come from broad geographic segments, including urban, suburban and rural areas, which reflects the varied characteristics and portability of our store locations.

Our Communities

One of our founding principles is to be an active member and steward of the communities we serve. As a commitment to this principle, we:

- provide extensive free educational services to customers in the form of lectures, classes, printed resources, online resources, publications and one-on-one nutrition coaching;

- participate in health fairs, school outreach, community wellness events and other activities to engage with and educate the community;

- disseminate new research on nutrition information;

- participate in the legislative and regulatory process at local, state and national levels so that our customers have access to quality food and dietary supplements and the educational resources to guide their own wellness;

continually strive to source products and services from local producers and vendors;

carefully collect all of our excess or distressed food and merchandise and donate it to local non-profit organizations;

provide cash to local food banks, making donation determinations based on the number of customers who shop our stores with their own bags;

do not provide paper or plastic bags at our registers and encourage use of reusable totes;

reduce our energy costs and carbon footprint using efficient heating, ventilation and air conditioning, lighting, and refrigerating systems;

implement strategies to eliminate excess packaging, energy and transportation costs;

recycle and reuse paper, plastic, glass and electronic products whenever possible; and

use healthy and environmentally responsible building materials and finishes in our new stores and remodels.

Marketing and Advertising

A significant portion of our marketing efforts is focused on educating our customers on the benefits of natural and organic grocery products and dietary supplements. Our customer outreach programs provide practical general nutrition knowledge to a variety of groups and individuals, schools, businesses, families and seniors. These educational efforts fulfill one of our founding principles and also offer us the opportunity to build relationships with our customers.

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Health Hotline. At the heart of our marketing efforts is our *Health Hotline*, a 28-page newsletter and sales flyer which contains a mix of in-depth health and nutrition articles, along with a selection of popular sale items. The articles aim to be relevant, science-based and written to reflect the most recent research findings. The full version of the *Health Hotline* is published eight times per year and is mailed to over 280,000 subscribers by United States Mail. Additionally, approximately 140,000 copies of each release are distributed in our stores. Over 3.8 million copies of a condensed version of the *Health Hotline*, which typically emphasizes only one article or topic, are inserted into the newspaper in many of our communities approximately 35 times per year. In addition, an electronic version of the condensed *Health Hotline* is distributed to over 80,000 subscribers. Generally, we negotiate with our suppliers for significantly lower costs on *Health Hotline* sale items, which in turn allows us to offer low sale prices to our customers. Focused staff training at all locations occurs congruent with the release of each *Health Hotline* to ensure that store staff are familiar with the content in each issue.

Web Sites and Social Media. We maintain *www.naturalgrocers.com* as our official company website to host store information, sales flyers, educational materials, product information, policies and contact forms, advocacy and news items and e-commerce activities. We believe the continued growth of site visitors, page views and other metrics of our website activity indicates that our content is timely and informative to the communities we serve. Our website is interlinked with other online and social media outlets, including Facebook, Foursquare, Google Places, Yelp, Twitter, Pinterest and others.

Television Commercials. We occasionally run television commercials in our markets. The commercials are produced locally and primarily feature members of the Isely family.

Billboards. We use billboards in our marketing efforts. These billboards typically are near, or on the same site as, our stores.

New Store Openings. We use various targeted marketing efforts to support the successful introduction of our new stores in their individual markets. In addition to the distribution of our *Health Hotline* newsletter and internet and social media efforts targeted to the region, we utilize direct mail distribution of a series of introductory postcards promoting our brand and providing discounts and other incentives for new customers. We also focus on community relationship-building activities including a series of lectures and cooking and other demonstrations in each new store’s community room and/or demonstration kitchen.

Upcoming Initiatives. We are currently reviewing our marketing communications strategy, collateral marketing materials and digital engagement platform (including our website, *www.naturalgrocers*.com) with the objective of increasing their reach and effectiveness. In order to support our marketing and advertising efforts, we are analyzing several initiatives that may be implemented during fiscal year 2015. These initiatives include a redesign of our website to enhance functionality and create a more engaging user experience and exploring options to include additional services through other digital platforms, such as digital coupons, home delivery services and a loyalty program. The website redesign is intended to be part of an overall enhanced branding strategy that we expect will more effectively communicate our brand's unique and compelling attributes, including our founding principles. We also plan to increase our use of digital engagement methods to increase awareness of an affinity for our brand among consumers, bloggers and on-line influencers. We also believe that the recently expanded role of the Nutritional Health Coach to focus on relationship-building opportunities in our communities and with our customers will enhance these marketing and branding initiatives.

Competition

The grocery and dietary supplement retail business is a large, fragmented and highly competitive industry. 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, 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, mail order and online retailers and multi-level marketers. Each of these outlets competes with us on the basis of price, selection, quality, customer service, shopping experience or any combination of these factors. 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.

Seasonality

Our business is active throughout the calendar year and does not experience significant fluctuation caused by seasonal changes in consumer purchasing.

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Insurance and Risk Management

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

Trademarks and Other Intellectual Property

We believe that our intellectual property is important to the success of our business. We have received the registration of trademarks not only for *Vitamin Cottage* and *Health Hotline* but also for our logo, *Natural Grocers by Vitamin Cottage* ® and *Vitamin Cottage Natural Grocers*® for appropriate categories of trade. In addition, we have received the registration of a service mark for *EDAP - Every Day Affordable Price*. We do not own or license for use any patents, franchises or concessions that are material to our business. Our trademarks are generally valid and may be renewed indefinitely as long as they are in use and their registrations are property maintained.

Information Technology Systems

We have made significant investments in overhead and information technology infrastructure, including purchasing, receiving, inventory, point of sale, warehousing, distribution, accounting, reporting and financial systems. We use an ERP system with integrated merchandise management, reporting and accounting system at all of our stores, as well as at our bulk food repackaging facility and distribution center and for corporate functions including accounting, reporting and purchasing. Our ERP system application support and hardware functions are outsourced, which allows us to focus on our core business. We substantially completed the implementation of an enterprise wide HRIS in fiscal year 2014 which provides the opportunity to more effectively onboard and train our employees at all locations.

Regulatory Compliance

The safety, formulation, manufacturing, processing, packaging, importation, labeling, promotion, advertising and distribution of products we sell in our stores, including private label products, are subject to regulation by several federal agencies, including the FDA, the Federal Trade Commission (FTC), the USDA, the Consumer Product Safety

Commission and the Environmental Protection Agency and various agencies of the states and localities. Pursuant to the Food, Drug, and Cosmetic Act (FDCA), the FDA regulates the safety, formulation, manufacturing, processing, packaging, labeling, importation and distribution of food and dietary supplements (including vitamins, minerals, amino acids and herbs). In addition, the FTC has jurisdiction to regulate the promotion and advertising of these products.

Dietary Supplements. The FDCA has been amended several times with respect to dietary supplements, in particular by the Dietary Supplement Health and Education Act of 1994 (DSHEA). DSHEA established a framework governing the composition, safety, labeling, manufacturing and marketing of dietary supplements, defined “dietary supplement” and “new dietary ingredient” and established new statutory criteria for evaluating the safety of substances meeting the respective definitions. In the process, DSHEA removed dietary supplements and new dietary ingredients from pre-market approval requirements that apply to food additives and pharmaceuticals and established a combination of “notification” and “post marketing controls” for regulating product safety. Notwithstanding, non-dietary ingredients in a dietary supplement remain subject to the FDA’s food additive authorities. The FDA does not require notification to market a dietary supplement if it contains only dietary ingredients that were present in the United States food supply prior to DSHEA’s enactment on October 15, 1994. However, for a dietary ingredient not present in the food supply prior to this date, the manufacturer must provide the FDA with information supporting the conclusion that the ingredient will reasonably be expected to be safe at least 75 days before introducing a new dietary ingredient into interstate commerce. As required by the Food Safety Modernization Act (FSMA), the FDA issued draft guidance in July 2011, which attempted to clarify when an ingredient would be considered a “new dietary ingredient,” the evidence needed to document the safety of a new dietary ingredient and appropriate methods for establishing the identity of a new dietary ingredient. The draft guidance has not been finalized. If finalized, the draft guidance may cause dietary supplement products available in the market before DSHEA to be classified to include a “new dietary ingredient” if the dietary supplement product was produced using manufacturing processes different from those used in 1994.

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DSHEA also empowered the FDA to establish good manufacturing practice regulations governing key aspects of the production of dietary supplements. DSHEA expressly permits dietary supplements to bear statements describing how a product affects the structure, function and general well-being of the body. Although manufacturers must be able to substantiate any such statement, no pre-market approval authorization is required for such statements and manufacturers need only notify FDA that they are employing a given claim. No statement may expressly or implicitly represent that a dietary supplement will diagnose, cure, mitigate, treat or prevent a disease. DSHEA does, however, authorize supplement sellers to provide “third-party literature,” (e.g., a reprint of a peer-reviewed scientific publication linking a particular dietary ingredient with health benefits) in connection with the sale of a dietary supplement to consumers. This provision is an exception to the FDA’s broad powers over the promotion of regulated products. Accordingly, the authorization is limited and applies only if the publication is printed in its entirety, is not false or misleading, presents a balanced view of the available scientific information and does not “promote” a particular manufacturer or brand of dietary supplement and is displayed in an area physically separate from the dietary supplements.

Food. The FDA has comprehensive authority to regulate the safety of food and food ingredients other than dietary supplements. Food additives and food contact substances are subject to pre-market approvals or notification requirements. The FDA’s overall food safety authority was dramatically enhanced in 2011 with the passage of the FSMA. The FSMA required the FDA to issue regulations mandating that risk-based preventive controls be observed by the majority of food producers. Regulations and rules issued under FSMA are in varying degrees of finalization. Regardless, the FDA’s authority under FSMA applies to all domestic food facilities and, by way of imported food supplier verification requirements, to all foreign facilities that supply us with food products. In addition, the FSMA required the FDA to establish science-based minimum standards for the safe production and harvesting of produce, to identify “high risk” foods and “high risk” facilities and instructed the FDA to set goals for the frequency of FDA inspections of such high risk facilities as well as non-high risk facilities and foreign facilities from which food is imported into the United States. With respect to both foods and dietary supplements, the FSMA meaningfully augmented the FDA’s ability to access producers’ records and suppliers’ records. This increased access could cause the FDA to identify areas of concern it had not previously considered to be problematic for our suppliers and contract manufacturers. The FSMA also gives the FDA authority to require food producers, distributors and sellers to recall adulterated or misbranded food if the FDA determines that there is a reasonable probability that the food will cause serious adverse health consequences to persons or animals. Additionally, the FSMA increases the FDA’s authority for administrative detentions of adulterated and misbranded foods. The FSMA also could cause enhanced tracking and tracing of food requirements and, as a result, added recordkeeping burdens upon our suppliers and contract manufacturers.

The FDA also exercises broad jurisdiction over the labeling and promotion of food. Labeling is a broad concept that, under certain circumstances, extends even to product-related claims and representations made on a company’s website or similar printed or graphic medium. All foods, including dietary supplements, must bear labeling that provides consumers with essential information with respect to ingredients, product weight, etc. The FDA administers a pre-market authorization program applicable to foods and supplements alike regarding the use of “nutrient content” claims (e.g., “high in antioxidants,” “low in fat,” etc.), “health” claims (claims describing the relationship between a food substance and a health or disease condition), and “natural and “all natural” claims. “Organic” claims, however, are primarily regulated by the USDA. In addition, the FDA has authority over products falsely or misleadingly labeled “organic.” Products labeled “organic” must be certified by an accredited agent as compliant with USDA-established standards.

FDA Enforcement. The FDA has broad authority to enforce the provisions of the FDCA applicable to the safety, labeling, manufacturing and promotion of foods and dietary supplements, including powers to issue a public warning letter to a company, publicize information about illegal products, institute an administrative detention of food, request or order a recall of illegal products from the market, and request the Department of Justice to initiate a seizure action, an injunction action or a criminal prosecution in the United States courts. Pursuant to the FSMA, the FDA also has the power to refuse the import of any food or dietary supplement from a foreign supplier that is not appropriately verified as in compliance with all FDA laws and regulations. Moreover, the FDA has the authority to administratively suspend the registration of any facility producing food, including supplements, deemed to present a reasonable probability of causing serious adverse health consequences.

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

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

Furthermore, to ensure compliant practices, our employees working in our stores are trained regularly on how to provide customer service using an educational approach that is ethical, honest, accurate and does not cross over into a scope of practice reserved for licensed healthcare professionals. For instance, we do not allow discussion of any "disease" or "cure." Instead, we focus on how the structure and function of the body is affected by lifestyle choices and the different nutritional components of an individual's diet, including those contained in dietary supplements. Our customers are encouraged to make informed decisions about their diet, lifestyle, and possible need for supplementation. We also conduct internal compliance reviews on all free nutrition literature that we make available to our customers upon request with the goal of ensuring that these materials only reference relevant dietary supplement ingredients and not any particular brands or products. One responsibility of the Nutritional Health Coach is to oversee our FDA and FTC compliance measures. We believe that our nutrition education practices are in compliance with federal and state requirements, but a finding to the contrary could pose significant issues with respect to our business and reputation among our customers or otherwise have a material adverse effect on our business.

New or revised government laws and regulations affecting our business or our industry, such as those relating to genetically modified foods, could result in additional compliance costs and civil remedies. The risks associated with these laws and regulations are further described under the caption "Risk Factors."

Segment Information

We have one reporting segment, natural and organic retail stores, through which we conduct all of our business. Please see the Consolidated Financial Statements of the Company for the fiscal year ended September 30, 2014, set forth in Part IV of this report on Form 10-K, for financial information regarding this segment.

Available Information

Our website is located at *www.naturalgrocers.com*. We will make our periodic reports and other information filed with or furnished to the Securities and Exchange Commission (SEC), available, free of charge, through our website as soon as reasonably practicable after those reports and other information are electronically filed with or furnished to the SEC. In addition, our Corporate Governance Guidelines, the charters for our Audit Committee and Compensation Committee, and our Code of Ethics are publicly available on our website at *www.naturalgrocers.com* under the "Investor Relations – Corporate Governance" section, and we will post any amendments to, or waivers from, a provision of this Code of Ethics on our website, at the address and location specified above. A printed copy of this information is also available without charge by sending a written request to Corporate Secretary, Natural Grocers by Vitamin Cottage, Inc., 12612 West Alameda Parkway, Lakewood, CO 80228. You may read and copy any materials we file with the SEC at the Securities and Exchange Commission Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The SEC also maintains a website that contains our reports and other information at *www.sec.gov*. Information on our website or any other website is not incorporated by reference into this report on Form 10-K.

Item 1A. Risk Factors.

Our business, financial condition and results of operations can be materially impacted by a number of factors which could cause our actual results to vary materially from recent results or from our anticipated future results. If any of the following risks actually occurs, our business, financial condition, results of operations, cash flow and prospects could be materially and adversely affected. As a result, the trading price of our common stock could decline and you could lose all or part of your investment in our common stock. Accordingly, you should carefully consider the risks described below as well as the other information and data included in this Annual Report on Form 10-K.

Risks related to our business

We may not be successful in our efforts to grow.

Our continued growth largely depends on our ability to increase sales in our existing stores and successfully open and operate new stores on a profitable basis. Our operating results have been, and are expected to continue to be, materially impacted by fluctuations in comparable store sales. Our comparable store sales growth could be lower than our historical average for various reasons, including the opening of new stores that cannibalize sales in existing stores, increased competition, general economic conditions, regulatory changes, price changes as a result of competitive factors and product pricing and availability.

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During fiscal years 2014 and 2013, we opened 15 and 13 new stores, respectively. We plan to open 18 new stores, relocate three existing stores and remodel two stores in fiscal year 2015. Delays or failures in opening new stores, or achieving lower than expected sales in new stores, could materially and adversely affect our growth. Our plans for continued expansion could place increased demands on our financial, managerial, operational and administrative resources. For example, our planned expansion will require us to increase the number of people we employ and may require us to upgrade our management information system and our distribution infrastructure. We currently operate a single bulk food repackaging facility and distribution center, which houses our bulk food repackaging operation. In order to support our recent and expected future growth and to maintain the efficient operation of our business, we may need to add additional distribution centers in the future. These increased demands and operating complexities could cause us to operate our business less efficiently, which could materially and adversely affect our operations, financial performance and ability to grow in the future.

Our ability to successfully open new stores depends upon a number of factors, including our ability to select suitable sites for our new store locations, to negotiate and execute leases, to coordinate the contracting work on our new stores, to identify and recruit store managers, Nutritional Health Coaches and other staff, to secure and manage the inventory necessary for the launch and successful operation of our new stores and to effectively promote and market our new stores. If we are ineffective in performing these activities, then our efforts to open and operate new stores may be unsuccessful or unprofitable, and we may be unable to execute our growth plans.

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

We have actively pursued new store growth and plan to continue doing so in the future. Our new store openings may not be successful or reach the sales and profitability levels of our existing stores. Although we target particular levels of cash-on-cash returns and capital investment for each of our new stores, new stores may not meet these targets. Any store we open may not be profitable or achieve operating results similar to those of our existing stores. New store openings may negatively impact our financial results in the short-term due to the effect of store opening costs and lower sales and contribution to overall profitability during the initial period following opening. New stores build their sales volume and their customer base over time and, as a result, generally have lower margins and higher operating expenses, as a percentage of net sales, than our existing stores. New stores may not achieve sustained sales and operating levels consistent with our more mature store base on a timely basis or at all. This may have an adverse effect on our financial condition and operating results.

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

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

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

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

Consumer preferences often change rapidly and without warning, moving from one trend to another among many product or retail concepts. Our performance is impacted by trends regarding natural and organic products, dietary supplements and at-home meal 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, reduced or changed consumer choices and the cost of these products. Our store offerings are comprised of natural and organic products and dietary supplements. A change in consumer preferences away from our offerings, including as a result of, among other things, reductions or changes in our offerings, would have a material adverse effect on our business. Additionally, negative publicity over the safety of any such items, or upgraded standards that reduce or change consumer choices, may adversely affect demand for our products and could result in lower customer traffic, sales and results of operations. Reduced or changed consumer choices may result from, among other things, the implementation of our requirements for dairy products that satisfy our pasture-based, non-confinement standards.

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If we are unable to anticipate and satisfy consumer merchandise preferences in the regions where we operate, our net sales may decrease, and we may be forced to increase markdowns of slow-moving merchandise, either of which could have a material adverse effect on our business, financial condition and results of operations.

Our inability to maintain or improve levels of comparable store sales could cause our stock price to decline.

We may not be able to restore, maintain or improve the levels of comparable store sales that we have experienced in the past. In addition, our overall comparable store sales may further fluctuate in the future. A variety of factors affect comparable store sales, including:

- our ability to execute our business strategy effectively, including successfully opening new stores that achieve sales consistent with our existing stores;
- consumer preferences;
- competition;
- economic conditions;
- regulatory changes;
- product pricing and availability;
- in-store merchandising-related activities;
- consumer confidence;
- unusually strong initial sales performance by our new stores; and
- our ability to source and distribute products efficiently.

In addition, many specialty retailers have been unable to sustain high levels of comparable store sales during and after periods of substantial expansion. These factors may cause our comparable store sales results to be materially lower than in recent periods, which could have a material adverse effect on our business, financial condition and results of operations, and could result in a decline in the price of our common stock.

Our comparable store sales and quarterly financial performance may fluctuate for a variety of reasons.

Our comparable store sales and quarterly results of operations have fluctuated in the past, and we expect them to continue to fluctuate in the future. A variety of other factors affect our comparable store sales and quarterly financial performance, including:

- changes in our merchandising strategy or product mix;
- performance of our newer and remodeled stores;
- the effectiveness of our inventory management;
- the timing and concentration of new store openings, and the related additional human resource requirements and pre-opening and other start-up costs;
- the cannibalization of existing store sales by new store openings;
- levels of pre-opening expenses associated with new stores;
- timing and effectiveness of our marketing activities;
- seasonal fluctuations due to weather conditions and extreme weather-related disruptions;
- actions by our existing or new competitors, including pricing changes;

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- supply shortages; and

- general United States economic conditions and, in particular, the retail sales environment.

Accordingly, our results for any one fiscal year or quarter are not necessarily indicative of the results to be expected for any other year or quarter, and comparable store sales of any particular future period may decrease. In the event of such a decrease, the price of our common stock would likely decline. For more information on our results of operations for the fiscal year 2014, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Disruptions in the worldwide economy may adversely affect our business, results of operations and financial condition and could negatively impact our ability to execute our growth strategy.

Adverse and uncertain economic conditions may impact demand for the products we sell in our stores. Consumer spending and levels of disposable income, including spending for natural and organic grocery and dietary supplement products that we sell, are affected by, among other things, prevailing economic conditions, levels of employment, salaries and wages, interest rates, the availability of credit, tax rates, housing market conditions, consumer confidence, political instability and consumer perception of economic conditions. The outbreak or escalation of war, the occurrence of terrorist acts or other hostilities in or affecting the United States, or concern regarding epidemics in the United States or in international markets could also lead to a decrease in spending by consumers. In the event of an economic slowdown, consumer spending could be adversely affected, and we could experience lower net sales than expected. We could be forced to delay or slow our new store growth plans, which could have a material adverse effect on our business, financial condition and results of operations. In addition, our ability to manage normal commercial relationships with our suppliers, manufacturers of our private label products, distributors, customers and creditors may suffer. Customers may shift purchases to lower-priced or other perceived value offerings during economic downturns. In particular, customers may reduce the amount of natural and organic products that they purchase and instead purchase conventional offerings, which generally have lower retail prices, at other stores. In addition, consumers may choose to purchase private label products at other stores rather than branded products because they are generally less expensive. Suppliers may become more conservative in response to these conditions and seek to reduce their production. Our results of operations depend upon, among other things, our ability to maintain and increase sales volume with our existing customers, to attract new customers and to provide products that appeal to customers at prices they are willing and able to pay. Prolonged unfavorable economic conditions may have an adverse effect on our sales and profitability.

We may be unable to compete effectively in our markets, which are highly competitive.

The markets for natural and organic groceries and dietary supplements are highly competitive, with few barriers to entry. Our competition varies by market and includes conventional, natural, gourmet and specialty food markets, mass and discount retailers, warehouse clubs, independent health food stores, dietary supplement retailers, drug stores, farmers markets, mail order and online retailers and multi-level marketers. Many of our competitors are larger, more established and have greater financial, marketing and other resources than us, and may be able to adapt to changes in consumer preferences more quickly, devote greater resources to the marketing and sale of their products, or generate greater brand recognition. As a result, we may lose market share to our competitors, which could have a material adverse effect on our business, financial condition and results of operations.

Our inability to maintain or increase our operating margins could adversely affect our results of operations and the price of our stock.

We intend to increase our operating margins by leveraging more efficiencies of scale, additional improved systems, further cost discipline, added focus on appropriate store labor levels and even more disciplined product selection. If we are unable to successfully manage the potential difficulties associated with store growth, we may not be able to capture the efficiencies of scale that we expect from expansion. If we are not able to continue to capture greater efficiencies of scale, improve our systems, further enhance our cost discipline and increase our focus on appropriate store labor levels and disciplined product selection, we may not be able to achieve our goals with respect to operating margins. In addition, if we do not adequately refine and improve our various ordering, tracking and allocation systems, we may not be able to increase sales and reduce inventory shrink. As a result, our operating margins may stagnate or decline, which could have a material adverse effect on our business, financial condition and results of operations and adversely affect the price of our stock.

A reduction in traffic to anchor stores in the shopping areas in close proximity to our stores could significantly reduce our sales and leave us with unsold inventory, which could have a material adverse effect on our business, financial condition and results of operations.

Many of our stores are located in close proximity to shopping areas that may also accommodate other well-known anchor stores. Sales at our stores are derived, in part, from the volume of traffic generated by the other anchor stores in the shopping areas where our stores are located. Customer traffic may be adversely affected by regional economic downturns, a general downturn in the local area where our store is located, long-term nearby road construction projects, the closing of nearby anchor stores or other nearby stores or the decline of the shopping environment in a particular shopping area. Any of these events would reduce our sales and leave us with excess inventory, which could have a material adverse effect on our business, financial condition and results of operation. In response to such events, we may be required to increase markdowns or initiate marketing promotions to reduce excess inventory, which would further decrease our gross profits and net income.

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If we or our third-party suppliers fail to comply with regulatory requirements, or are unable to provide products that meet our specifications, our business and our reputation could suffer.

If we or our third-party suppliers, including suppliers of our private label products, fail to comply with applicable regulatory requirements or to meet our specifications for quality, we could be required to take costly corrective action and our reputation could suffer. We do not own or operate any manufacturing facilities, except for our bulk food repackaging facility and distribution center discussed below, and therefore depend upon independent third-party vendors to produce our private label branded products, such as vitamins, minerals, dietary supplements, body care products, food products and bottled water. Third-party suppliers of our private label products may not maintain adequate controls with respect to product specifications and quality. Such suppliers may be unable to produce products on a timely basis or in a manner consistent with regulatory requirements. We depend upon our bulk food repackaging facility and distribution center for the majority of our private label bulk food products. We may also be unable to maintain adequate product specification and quality controls at our bulk food repackaging facility and distribution center, or produce products on a timely basis and in a manner consistent with regulatory requirements. In addition, we may be required to find new third-party suppliers of our private label products or to find third-party suppliers to source our bulk foods. There can be no assurance that we would be successful in finding such third-party suppliers that meet our quality guidelines.

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

As a retailer of food and dietary supplements and a seller of many of our own private label products, we are subject to numerous federal and state health and safety laws and regulations. Our suppliers and contract manufacturers are also subject to such laws and regulations. These laws and regulations apply to many aspects of our business, including the manufacturing, packaging, labeling, distribution, advertising, sale, quality and safety of our products, as well as the health and safety of our employees and the protection of the environment. In the United States, we are subject to regulation by various federal government agencies, including the FDA, the USDA, the FTC, the Occupational Safety and Health Administration, the Consumer Product Safety Commission and the Environmental Protection Agency, as well as various state and local agencies. We are also subject to the USDA's Organic Rule, which facilitates interstate commerce and the marketing of organically produced food, and provides assurance to our customers that such products meet consistent, uniform standards. Compliance with the USDA's Organic Rule also places a significant burden on some of our suppliers, which may cause a disruption in some of our product offerings. In addition, our sales of dietary supplements are regulated under DSHEA. DSHEA expressly permits dietary supplements to bear statements describing how a product affects the structure, function and general well-being of the body. However, no statement may expressly or implicitly represent that a dietary supplement will diagnose, cure, mitigate, treat or prevent a disease. If these laws and regulations were violated by our management, employees, suppliers, distributors or vendors, we could be subject to fines, penalties and sanctions, including injunctions against future shipment and sale of products, seizure and confiscation of products, prohibition on the operation of our stores, restitution and disgorgement of profits, operating restrictions and criminal prosecution.

In connection with the marketing and advertisement of our products, we could be the target of claims relating to false or deceptive advertising, including under the auspices of the FTC and the consumer protection statutes of some states. These events could interrupt the marketing and sales of products in our stores, including our private label products, severely damage our brand reputation and public image, increase the cost of products in our stores, result in product recalls or litigation, and impede our ability to deliver merchandise in sufficient quantities or quality to our stores, which could result in a material adverse effect on our business, financial condition and results of operations.

New or revised government laws and regulations have been adopted in recent years, such as those relating to genetically modified foods, could result in additional compliance costs and the increased use of civil remedies to enforce such laws and regulations. Additionally, increased enforcement by government agencies could result in such costs and remedies, as well as the payment of fines or penalties imposed by such agencies.

The FSMA passed in January 2011, granted the FDA greater authority over the safety of the national food supply and required the FDA to issue regulations mandating that risk-based preventive controls be observed by the majority of food producers. Regulations and rules issued under FSMA are in varying degrees of finalization. Regardless, the FDA’s authority under FSMA applies to all domestic food facilities and, by way of imported food supplier verification requirements, to all foreign facilities that supply food products. In addition, the FSMA required the FDA to establish science based minimum standards for the safe production and harvesting of produce, required the FDA to identify “high risk” foods and “high risk” facilities and instructed the FDA to set goals for the frequency of FDA inspections of such high risk facilities as well as non-high risk facilities and foreign facilities from which food is imported into the United States. With respect to both food and dietary supplements, the FSMA meaningfully augmented the FDA’s ability to access a producer’s records and a supplier’s records. This increased access could permit the FDA to identify areas of concern it had not previously considered to be problematic either for us or for our suppliers. The FSMA also could result in the implementation of enhanced tracking and tracing of food requirements and, as a result, added recordkeeping burdens upon our suppliers. In addition, under the FSMA, the FDA now has the authority to inspect certifications and therefore evaluate whether foods and ingredients from our suppliers are compliant with the FDA’s regulatory requirements. Such inspections may delay the supply of certain products or result in certain products being unavailable to us for sale in our stores.

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DSHEA established that no notification to the FDA is required to market a dietary supplement if it contains only dietary ingredients that were present in the United States food supply prior to DSHEA's enactment. However, for a dietary ingredient not present in the food supply prior to DSHEA's enactment, the manufacturer is required to provide the FDA with information supporting the conclusion that the ingredient will reasonably be expected to be safe at least 75 days before introducing a new dietary ingredient into interstate commerce. As required by the FSMA, the FDA issued draft guidance in July 2011, which attempted to clarify when an ingredient would be considered a "new dietary ingredient," the evidence needed to document the safety of a new dietary ingredient and appropriate methods for establishing the identity of a new dietary ingredient. The draft guidance has not yet been finalized. If finalized, the draft guidance may cause dietary supplement products available in the market before DSHEA to be classified to include a new dietary ingredient if the dietary supplement product was produced using manufacturing processes different from those used in 1994. Accordingly, the finalization and adoption of the draft FDA guidance or similar guidance could materially adversely affect the availability of dietary supplement products.

Furthermore, in recent years, the FDA has been and continues to be aggressive in enforcing its regulations with respect to nutrient content claims (e.g., "low fat," "good source of," "calorie free," etc.), unauthorized "health claims" (claims that characterize the relationship between a food or food ingredient and a disease or health condition) and other claims that impermissibly suggest therapeutic benefits for certain foods or food components. Such FDA enforcement with respect to such promotional practices could result in costly product changes, potential private litigation, bad publicity and loss of consumer goodwill.

We are also subject to laws and regulations more generally applicable to retailers, including labor and employment, taxation, zoning and land use. In addition, changes in federal and state minimum wage laws and other laws relating to employee benefits could cause us to incur additional wage and benefits costs, which could hurt our profitability.

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

We may experience product recalls, withdrawals or seizures which could reduce our sales and adversely affect our results of operations.

We may be subject to product recalls, withdrawals or seizures if any of the products we sell is believed to cause injury or illness or if we are alleged to have violated governmental regulations in the labeling, promotion, sale or distribution of those products. A significant recall, withdrawal or seizure of any of the products we sell may require significant management attention, would likely result in substantial and unexpected costs and may adversely affect our business, financial condition or results of operations. Furthermore, a recall, withdrawal or seizure of any of our products may adversely affect consumer confidence in our brands and thus decrease consumer demand for our products. We rely on our suppliers to ensure that the products they manufacture and sell to us comply with all applicable regulatory and legislative requirements. In general, we seek representation and warranties, indemnification and/or insurance from our suppliers. However, even with adequate insurance and indemnification, any claims of non-compliance could significantly damage our reputation and consumer confidence in our products. In addition, the failure of those products to comply with applicable regulatory and legislative requirements could prevent us from marketing the products or require us to recall or remove such products from the market, which in certain cases could materially and adversely affect our business, financial condition and results of operations.

The activities of our Nutritional Health Coaches and our nutrition education services may be impacted by government regulation or our inability to secure adequate liability insurance.

Some of the activities of our Nutritional Health Coaches who, among other duties, provide nutrition oriented educational services to our customers, may be subject to state and federal regulation, and oversight by professional organizations. In the past, the FDA has expressed concerns regarding summarized health and nutrition related information that (1) does not, in the FDA's view, accurately present such information, (2) diverts a consumer's attention and focus from FDA-required nutrition labeling and information or (3) impermissibly promotes drug-type disease related benefits. Although we have provided training to our Nutritional Health Coaches on relevant regulatory requirements, we cannot control the actions of such individuals, and our Nutritional Health Coaches may not act in accordance with such regulations. If our Nutritional Health Coaches or other employees do not act in accordance with regulatory requirements, we may become subject to penalties which could have a material adverse effect on our business. We believe we are currently in compliance with relevant regulatory requirements, and we maintain professional liability insurance on behalf of our Nutritional Health Coaches in order to mitigate risks associated with our Nutritional Health Coaches' nutrition oriented educational activities. However, we cannot predict the nature of future government regulation and oversight, including the potential impact of any such regulation on the services currently provided by our Nutritional Health Coaches. Furthermore, the availability of professional liability insurance or the scope of such coverage may change, or our insurance coverage may prove inadequate, which may adversely impact the ability of our Nutritional Health Coaches to provide some services to our customers. The occurrence of any such developments could negatively impact the perception of our brand, our sales and our ability to attract new customers.

Our future business, results of operations and financial condition may be adversely affected by reduced availability of organic products or dairy products that satisfy our pasture-based, non-confinement standards.

Our ability to ensure a continuing supply of organic products and dairy products that satisfy our pasture-based, non-confinement standards at competitive prices depends on many factors beyond our control, such as the number and size of farms that grow organic crops or raise organic livestock or satisfy our pasture-based, non-confinement standards, the vagaries of these farming businesses and our ability to accurately forecast our sourcing requirements. The organic ingredients used in many of the products we sell are vulnerable to adverse weather conditions and natural disasters, such as floods, droughts, frosts, earthquakes, hurricanes and pestilences. Adverse weather conditions and natural disasters can lower crop yields and reduce crop size and quality, which in turn could reduce the available supply of, or increase the price of, organic ingredients. Certain products we purchase from our suppliers include organic ingredients sourced offshore, and the availability of such ingredients may be affected by events in other countries. In addition, we and our suppliers compete with other food producers in the procurement of organic ingredients and dairy products that satisfy our pasture-based, non-confinement standards, which are often less plentiful in the open market than conventional ingredients and products. This competition may increase in the future if consumer demand increases for organic products and dairy products that satisfy our pasture-based, non-confinement standards. If supplies of organic ingredients and dairy products that satisfy our pasture-based, non-confinement standards are reduced or there is greater demand for such ingredients from us and others, we may not be able to obtain sufficient supply on favorable terms, or at all, which could impact our ability to supply products to our stores and may adversely affect our business, results of operations and financial condition.

The organic products we sell rely on independent certification and must comply with the requirements of independent organizations or certification authorities in order to be labeled as such. Certain products we sell in our stores can lose their “organic” certification if a contract manufacturing plant becomes contaminated with non-organic materials or if it is not properly cleaned after a production run, among other issues. The loss of any independent certifications could reduce the availability of organic products that we can sell in our stores and harm our business.

Disruptions affecting our significant suppliers, or our relationships with such suppliers, could negatively affect our business.

UNFI is our single largest third-party supplier, accounting for approximately 48% of our total purchases in fiscal year 2014. In addition, approximately 8% of our purchases were made through Albert’s Organics, a subsidiary of UNFI that distributes fresh produce and meat. In fiscal year 2012, we extended our long-term relationship with UNFI as our primary supplier of dry grocery and frozen food products through 2016. Due to this concentration of purchases from a single third-party supplier, the cancellation of our distribution agreement or the disruption, delay or inability of UNFI to deliver product to our stores may materially and adversely affect our operating results and we may be unable to establish alternative distribution channels on reasonable terms or at all.

Certain of our vendors use overseas sourcing to varying degrees to manufacture some or all of their products. Any event causing a sudden disruption of manufacturing or imports from such foreign countries, including the imposition of additional import restrictions, unanticipated political changes, increased customs duties, labor disputes, health epidemics, adverse weather conditions, crop failure, acts of war or terrorism, legal or economic restrictions on overseas suppliers’ ability to produce and deliver products, and natural disasters, could increase our costs and materially harm our operations, business and financial condition. Our business is also subject to a variety of other risks generally associated with indirectly sourcing goods from abroad, such as political instability, disruption of imports by labor disputes and local business practices. In addition, requirements imposed by the FSMA compel importers to verify that food products and ingredients produced by a foreign supplier comply with all applicable legal and regulatory requirements enforced by the FDA, which could result in certain products being deemed inadequate for import.

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The current geographic concentration of our stores creates exposure to local economies, regional downturns or severe weather or catastrophic occurrences.

As of September 30, 2014, we have store concentration in Colorado and Texas, operating 32 stores and 13 stores in those states, respectively, or a total of 51.7% of our stores. As a result, our business is currently more susceptible to regional conditions than the operations of more geographically diversified competitors, and we are vulnerable to economic downturns in those regions. Any unforeseen events or circumstances that negatively affect these areas could materially adversely affect our revenues and profitability. These factors include, among other things, changes in demographics, population, competition, consumer preferences, new or revised laws or regulations, fires, floods or other natural disasters in these regions.

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

We believe our continued success depends on our ability to maintain and grow the value of the *Natural Grocers by Vitamin Cottage* brand. Maintaining, promoting and positioning our brand and reputation will depend largely on the success of our marketing and merchandising efforts and our ability to provide a consistent, high quality customer experience. Brand value is based in large part on perceptions of subjective qualities, and even isolated incidents can erode trust and confidence, particularly if they result in adverse publicity, governmental investigations or litigation. Our brand could be adversely affected if we fail to achieve these objectives, or if our public image or reputation were to be tarnished by negative publicity. Sources of negative publicity may include, among others, social media posts, investment or financial community posts and poor reviews of stores, products, customer service and employment. Our reputation could also suffer from real or perceived issues involving the labeling or marketing of our products as “natural.” Although the FDA and USDA each has issued statements regarding the appropriate use of the word “natural,” there is no single, United States government regulated definition of the term “natural” for use in the food industry. The resulting uncertainty has led to consumer confusion, distrust and legal challenges. Plaintiffs have commenced legal actions against a number of food companies that market “natural” products, asserting false, misleading and deceptive advertising and labeling claims, including claims related to genetically modified ingredients. In limited circumstances, the FDA has taken regulatory action against products labeled “natural” but that nonetheless contain synthetic ingredients or components. Should we become subject to similar claims, consumers may avoid purchasing products from us or seek alternatives, even if the basis for the claim is unfounded. Adverse publicity about these matters may discourage consumers from buying our products. The cost of defending against any such claims could be significant. Any loss of confidence on the part of consumers in the truthfulness of our labeling or ingredient claims would be difficult and costly to overcome and may significantly reduce our brand value. Any of these events could adversely affect our reputation and brand and decrease our sales, which would have a material adverse effect on our business, financial condition and results of operations.

Perishable food product losses could materially impact our results of operations.

Our stores offer a significant number of perishable products. Our offering of perishable products may result in significant product inventory losses in the event of extended power or other utility outages, natural disasters or other catastrophic occurrences.

The decision by certain of our suppliers to distribute their specialty products through other retail distribution channels could negatively impact our revenue from the sale of such products.

Some of the specialty retail products that we sell in our stores are not generally available through other retail distribution channels such as drug stores, conventional grocery stores or mass merchandisers. In the future, our suppliers could decide to distribute such products through other retail distribution channels, allowing more of our competitors to offer these products, and adversely affecting the desirability of these products to our core customers, which could negatively impact our revenues.

Our ability to operate our business effectively could be impaired if we fail to retain or attract key personnel or are unable to attract, train and retain qualified employees.

Our business requires disciplined execution at all levels of our organization. This execution requires an experienced and talented management team. The loss of any member of our senior management team, particularly Kemper Isely or Zephyr Isely, our Co-Presidents since 1998, or Heather Isely or Elizabeth Isely, our Executive Vice Presidents since 1998, could have a material adverse effect on our ability to operate our business, our financial condition and results of operations, unless, and until, we are able to find a qualified replacement. Furthermore, our ability to manage our new store growth will require us to attract, motivate and retain qualified managers, Nutritional Health Coaches and store employees who understand and appreciate our culture and are able to represent our brand effectively in our stores. Competition for such personnel is intense, and we may be unable to attract, assimilate and retain the personnel required to grow and operate our business profitably.

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Any significant interruption in the operations of our bulk food repackaging facility and distribution center could disrupt our ability to deliver our merchandise in a timely manner.

We repackage and distribute some of the products we sell through our bulk food repackaging facility and distribution center in Golden, Colorado. Any significant interruption in the operation of our bulk food repackaging and distribution center infrastructure, such as disruptions due to fire, severe weather or other catastrophic events, power outages, labor disagreements, or shipping problems, could adversely impact our ability to receive and process orders, and distribute products to our stores. Such interruptions could result in lost sales, cancelled sales and a loss of customer loyalty to our brand. While we maintain business interruption and property insurance, if the operation of our distribution facility were interrupted for any reason causing delays in shipment of merchandise to our stores, our insurance may not be sufficient to cover losses we experience. This could have a material adverse effect on our business, financial condition and results of operations.

A widespread health epidemic could materially impact our business.

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

Union activity at third-party transportation companies or labor organizing activities among our employees could disrupt our operations and harm our business.

Independent third-party transportation companies deliver the majority of our merchandise to our stores and to our customers. Some of these third parties employ personnel represented by labor unions. Disruptions in the delivery of merchandise or work stoppages by employees of these third parties could delay the timely receipt of merchandise, which could result in cancelled sales, a loss of loyalty to our stores and excess inventory. While all of our employees are currently non-union, attempts on the part of our employees to organize labor or union activities among our employees could result in work slowdowns, reducing the efficiency of our operations, which could have a material adverse effect on our business, financial condition and results of operations.

Our management has limited experience managing a public company.

We are subject to various regulatory requirements, including those of the SEC and The New York Stock Exchange (NYSE). These requirements include, among other things, record keeping, financial reporting and corporate governance rules and regulations. Our management has been managing a public company since the Company's initial public offering (IPO), in fiscal year 2012, and therefore its overall experience in managing a public company remains limited. Our public company reporting obligations have increased, and continue to impose, demands on our internal infrastructure and resources. Although we have hired additional staff in order to comply with these requirements, we may be unable to retain the staff necessary to comply with these requirements in the future. In certain continuing respects, we rely on outside consultants and professionals to supplement our capacity to meet these requirements. Our business could be adversely affected if we are unable to fulfill our public company obligations.

Future events could result in impairment of long-lived assets, which may result in charges that adversely affect our results of operations and capitalization.

Our total assets included long-lived assets totaling $121.1 million at September 30, 2014. Long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Our impairment evaluations require use of financial estimates of future cash flows. Application of alternative assumptions could produce significantly different results. We may be required to recognize impairments of long-lived assets based on future economic factors such as unfavorable changes in estimated future undiscounted cash flows of an asset group.

We have significant lease obligations, which may require us to continue paying rent for store locations that we no longer operate.

Our stores, bulk food repackaging facility and distribution center and administrative facility are leased. We are subject to risks associated with our current and future real estate leases. Our costs could increase because of changes in the real estate markets and supply or demand for real estate sites. We generally cannot cancel our leases, so if we decide to close or relocate a location, we may nonetheless be committed to perform our obligations under the applicable lease including paying the base rent for the remaining lease term. As each lease expires, we may fail to negotiate renewals, either on commercially acceptable terms or any terms at all and may not be able to find replacement locations that will provide for the same success as current store locations. Of the current leases for our stores, one expires in fiscal year 2015, six expire in fiscal year 2016, one expires in fiscal year 2017, four expire in fiscal year 2018 and the remainder expire between fiscal years 2019 and 2062.

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Any material failure of our information systems could negatively impact our operations.

We are increasingly dependent on a variety of information systems to effectively manage the operations of our growing store base, including our supply chain. The failure of our information systems to perform as designed, including the failure of our vendors to maintain and make available software or the failure of our warehouse management software system to operate as expected or to support our distribution facility, could have an adverse effect on our business and results of operations. Any material failure or slowdown of our systems could disrupt our ability to track, record and analyze our merchandise, and could negatively impact our operations, including, among other things, our ability to process and receive shipments of goods and process financial and credit card transactions. Any security breaches of our information systems could disrupt our operational systems, resulting in a slowdown of our normal business activities or limitations on our ability to process credit card transactions. Moreover, leaks of proprietary information, including leaks of customers' private data, could weaken customer confidence in our company and our ability to compete in the food retail marketplace, which could have a material adverse effect on our business, financial condition and results of operations. Additionally, changes in technology could cause our information systems to become obsolete and it may be necessary to incur additional costs to upgrade such systems, and if our information systems prove inadequate to handle our growth, we could lose customers, which could have a material adverse effect on our business, financial condition and results of operations. We are also vulnerable to certain risks and uncertainties associated with our websites, including changes in required technology interfaces, website downtime and other technical failures, security breaches and consumer privacy concerns. Our failure to successfully respond to these risks could damage our reputation.

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

We currently maintain insurance customary for businesses of our size and type using a combination of insurance and self-insurance plans to provide for the potential liabilities for workers' compensation, general liability, professional liability, property insurance, director and officers' liability insurance, vehicle liability and employee health-care benefits. There are types of losses we may incur that cannot be insured against or that we believe are not economically reasonable to insure. Such losses could have a material adverse effect on our business and results of operations. In addition, liabilities associated with the risks that are retained by the Company are estimated, in part, by considering historical claims experience, demographic factors, severity factors and other actuarial assumptions. Our results could be materially impacted by claims and other expenses related to such plans if future occurrences and claims differ from these assumptions and historical trends.

If we are unable to protect our intellectual property rights, our ability to compete and the value of our brand could be harmed.

We believe that our trademarks or service marks, trade dress, copyrights, trade secrets, know-how and similar intellectual property are important to our success. In particular, we believe that the *Natural Grocers by Vitamin Cottage* name is important to our business, as well as to the implementation of our growth strategy. Our principal intellectual property rights include registered marks on *Vitamin Cottage*, *Natural Grocers by Vitamin Cottage*, *Vitamin Cottage Natural Grocers*, *EDAP - Every Day Affordable Price*, copyrights of our website content, rights to our domain names including *www.vitamincottage.com* and *www.naturalgrocers.com*, and trade secrets and know-how with respect to our product sourcing, sales and marketing and other aspects of our business. As such, we rely on trademark or service mark and copyright law, trade secret protection and confidentiality agreements with our employees and certain of our consultants, suppliers and others to protect our proprietary rights. If we are unable to defend or protect or preserve the value of our trademarks or service marks, copyrights, trade secrets or other proprietary rights for any reason, our brand and reputation could be impaired and we could lose customers.

Although several of our brand names are registered in the United States, we may not be successful in asserting trademark or service mark or trade name protection and the costs required to protect our trademarks or service marks and trade names may be substantial. In addition, the relationship between regulations governing domain names and laws protecting trademarks or service marks and similar proprietary rights is unclear. Therefore, we may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks or service marks and other proprietary rights. Additionally, other parties may infringe on our intellectual property rights and may thereby dilute our brand in the marketplace. Third parties could also bring additional intellectual property infringement suits against us from time to time to challenge our intellectual property rights. Any such infringement of our intellectual property rights by others, or claims by third parties against us, would likely result in a commitment of our time and resources to protect these rights through litigation or otherwise. If we were to receive an adverse judgment in such a matter, we could suffer further dilution of our trademarks or service marks and other rights, which could harm our ability to compete as well as our business prospects, financial condition and results of operations.

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Our products could suffer from real or perceived quality or food safety concerns and may cause unexpected side effects, illness, injury or death that could result in their discontinuance or expose us to lawsuits, any of which could result in unexpected costs and damage to our reputation.

We could be materially, adversely affected if consumers lose confidence in the safety and quality of products we sell. There is substantial governmental scrutiny of and public awareness regarding food safety. We believe that many customers hold us to a higher quality standard than other retailers. Many of our products are vitamins, herbs and other ingredients that are classified as foods or dietary supplements and are not subject to pre-market regulatory approval in the United States. Our products could contain contaminated substances, and some of our products contain ingredients that do not have long histories of human consumption. Previously unknown adverse reactions resulting from human consumption of these ingredients could occur. Unexpected side effects, illness, injury or death caused by our products could result in the discontinuance of sales of our products or prevent us from achieving market acceptance of the affected products. Such side effects, illnesses, injuries and death could also expose us to product liability or negligence lawsuits. Any claims brought against us may exceed our existing or future insurance policy coverage or limits. Any judgment against us that is in excess of our policy limits would have to be paid from our cash reserves, which would reduce our capital resources. Further, we may not have sufficient capital resources to pay a judgment in which case our creditors could levy against our assets. The real or perceived sale of contaminated or harmful products would cause negative publicity regarding our company, brand or products, including negative publicity in social media, which could in turn harm our reputation and net sales, which could have a material adverse effect on our business, financial condition and results of operations, or result in our insolvency.

Increase in the cost of raw materials could hurt our sales and profitability.

Costs of the raw agricultural commodities used in our private label products, including our bulk repackaged products, could increase. Such commodities are generally subject to availability constraints and price volatility caused by weather, supply conditions, government regulations, energy prices, price inflation and general economic conditions and other unpredictable factors. An increase in the demand for or a reduced supply of raw agricultural commodities could cause our vendors to seek price increases from us, which could cause the retail price we charge for certain products to increase, in turn decreasing our sales of such products. Supply shortages may cause certain items to be unavailable, which could negatively affect our sales. Our profitability may be adversely impacted as a result of such developments through reduced gross margins or a decline in the number and average size of customer transactions. The cost of construction materials we use to build and remodel our stores is also subject to significant price volatility based on market and economic conditions. Higher construction material prices would increase the capital expenditures needed to construct a new store or remodel an existing store and, as a result, could increase the rent payable by the Company under its leases.

Energy costs are a significant component of our operating expenses and increasing energy costs, unless offset by more efficient usage or other operational responses, may impact our profitability.

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

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

Postal rate increases, and increasing paper and printing costs affect the cost of our promotional mailings. Previous changes in postal rates increased the cost of our *Health Hotline* mailings and previous increases in paper and printing costs increased the cost of producing our *Health Hotline* newspaper inserts. In response to any future increase in mailing costs, we may consider reducing the number and size of certain promotional pieces. In addition, we rely on discounts from the basic postal rate structure, such as discounts for bulk mailings and sorting by zip code and carrier routes. We are not party to any long-term contracts for the supply of paper. We are also affected by increases in billboard costs and the cost of producing and broadcasting our television, radio and internet advertising pieces. Previous changes in broadcast rates resulted in an increase in the cost of our television commercials. In response to any future increase in broadcast costs, we may consider reducing the frequency, placement and length of certain promotional pieces. We are not party to any long-term contracts for broadcast time. Future increases in costs affecting our marketing, advertising and promotions could adversely impact our ability to advertise effectively and our profitability.

Our credit facility could limit our operational flexibility.

On December 12, 2013, we entered into an amended and restated credit facility (our Credit Facility). Our Credit Facility allows us to borrow up to $15.0 million, and an additional amount that may not exceed $10.0 million by obtaining an additional commitment or commitments. As of September 30, 2014, no borrowings were outstanding under our Credit Facility. Our Credit Facility is secured by a lien on substantially all of our assets and contains usual and customary restrictive covenants relating to our management and the operation of our business. These covenants, among other things, restrict our ability to incur additional indebtedness, grant liens, engage in certain merger, consolidation or asset sale transactions, make certain investments, make loans, advances, guarantees or acquisitions, engage in certain transactions with affiliates or permit certain sale and leaseback transactions without lender consent. We are also required to maintain certain financial ratios under our Credit Facility, including a consolidated leverage ratio and a consolidated fixed charge ratio. These covenants could restrict our operational flexibility, including our ability to open stores, and any failure to comply with these covenants or our payment obligations would limit our ability to borrow under our Credit Facility and, in certain circumstances, may allow the lender thereunder to require repayment.

We may need to raise additional debt or equity capital.

We have depended primarily on cash flow from our operations, borrowings from our Credit Facility and a portion of the net proceeds from our IPO to fund our business and execute on our growth strategy. From time to time, we may be required to seek additional equity or debt financing in order to fund capital expenditures or to provide additional working capital for our business, or to fund the execution of our growth strategy. In addition, changes in economic conditions, or market conditions requiring a shift in our business model could result in our need for additional debt or equity financing. We cannot now predict the timing or amount of any such capital requirements. We do not know whether we will be able to take any of such actions on a timely basis, on terms satisfactory to us or at all. If financing is not available to us on satisfactory terms, or at all, we may be unable to operate or expand our business or to successfully pursue our growth strategy, and our results of operations may suffer. Pursuant to the NYSE Listed Company Manual, in order to rely on the “controlled company” corporate governance exemptions, the Isely family is, or entities controlled by the Isely family are, required to retain more than 50% of the total voting power of our common shares for the election of directors. As long as we intend to remain a “controlled company,” these voting requirements will constrain our ability to issue additional shares of our common stock in the future.

Our political advocacy activities may reduce our customer count and sales.

We believe our ability to profitably operate our business depends, in part, upon our access to natural and organic products and dietary supplements. We attempt to protect our interest in this access through ongoing and proactive political advocacy campaigns, including participation in education programs, petitions, letter writing, phone calls, policy conferences, advisory boards, industry groups, public commentary and meetings with trade groups, office holders and regulators. We may publicly ally with and support trade groups, political candidates, government officials and regulators who support a particular policy we consider important to our business and in alignment with our principles regarding access to natural and organic products and dietary supplements. We may, from time to time, publicly oppose other trade groups, candidates, officeholders and regulators whose point of view we believe will harm our business, or impede access to nutritious food and dietary supplements. In some cases, we may lose customers and sales because our political advocacy activities are perceived to be contrary to those customers' points of view, political affiliations, political beliefs or voting preferences.

Effective tax rate changes and results of examinations by taxing authorities could materially impact our results of operations.

Our future effective tax rates could be adversely affected by our earnings mix being lower than historical results in states where we have lower statutory rates and higher than historical results in states where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities or by changes in tax laws or interpretations thereof. In addition, we are subject to periodic audits and examinations by the Internal Revenue Service (IRS), and other state and local taxing authorities. Our results could be materially impacted by the determinations and expenses related to proceedings by the IRS and other state and local taxing authorities.

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Failure to maintain adequate financial and management processes and controls could lead to errors in our financial reporting and could harm our ability to manage our expenses.

Our anticipated growth, and continuing reporting obligations as a public company, are placing a continuing and considerable strain on our financial and management systems, processes and controls, as well as on our personnel. In addition, as a public company, we are required to document and test our internal controls over financial reporting pursuant to Section 404 of Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), so that our management can periodically certify the effectiveness of such controls. As an “emerging growth company,” we have opted to take advantage of certain exemptions contained in the JOBS Act, and as a result, our independent registered public accounting firm will not be required to formally attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 until the later of the year following our first annual report required to be filed with the SEC, or the date we are no longer an “emerging growth company” as defined in the JOBS Act. We expect that we will remain an “emerging growth company” until the earliest of (a) the last day of our fiscal year following the fifth anniversary of our IPO on July 25, 2012, (b) the last day of our fiscal year in which we have annual gross revenue of $1.0 billion or more, (c) the date on which we have, during the previous three-year period, issued more than $1.0 billion in non-convertible debt, or (d) the date on which we are deemed to be a “large accelerated filer,” which will occur at such time as we have (1) an aggregate worldwide market value of common equity securities held by non-affiliates of $700 million or more as of the last business day of our most recently completed second fiscal quarter, (2) been required to file annual, quarterly and current reports under the Exchange Act for a period of at least 12 calendar months and (3) filed at least one annual report pursuant to the Exchange Act. As a result, we may qualify as an “emerging growth company” until as late as September 30, 2017. At such time, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. If our senior management is unable to conclude that we have effective internal control over financial reporting, or to certify the effectiveness of such controls, or if our independent registered public accounting firm cannot render an unqualified opinion on management’s assessment and the effectiveness of our internal control over financial reporting, or if material weaknesses in our internal controls are identified, we could be subject to regulatory scrutiny and a loss of public confidence, which could have a material adverse effect on our business and our stock price.

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

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

We are an "emerging growth company" and, although we do not now believe that investors have found our common stock less attractive since our IPO as a result, we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors in the future.

We are an "emerging growth company," as defined in the JOBS Act, and we may take advantage of certain exemptions from various reporting and other requirements that are applicable to other public companies that are not "emerging growth companies." For so long as we are an "emerging growth company," we will, among other things:

- not be required to comply with the auditor attestation requirements of Section 404(b) of Sarbanes-Oxley;
- not be required to hold a nonbinding advisory stockholder vote on executive compensation pursuant to Section 14A(a) of the Exchange Act;
- not be required to seek stockholder approval of any golden parachute payments not previously approved pursuant to Section 14A(b) of the Exchange Act;
- be exempt from any rule adopted by the Public Company Accounting Oversight Board requiring mandatory audit firm rotation or a supplemental auditor discussion and analysis; and
- be subject to reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements.

Although we do not now believe that investors have found our common stock less attractive since our IPO because we rely on certain of these exemptions, we cannot predict if investors may in the future view our common stock less favorably as a result of our "emerging growth company" status. If some investors in the future find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

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In addition, Section 107 of the JOBS Act provides that an "emerging growth company" can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended (Securities Act), for complying with new or revised accounting standards. An "emerging growth company" can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. However, we chose to "opt out" of such extended transition period, and as a result, we have complied and will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

Failure to protect our information systems against cyber-attacks or information security breaches, including failure to protect the integrity and security of individually identifiable data of our customers and employees, could expose us to litigation, damage our reputation and have a material adverse effect on our business.

We rely on computer systems and information technology to conduct our business. These systems are inherently vulnerable to disruption or failure, as well as internal and external security breaches, denial of service attacks or other disruptive problems caused by hackers. A failure of these systems could cause an interruption in our business which could materially and adversely affect our financial condition and results of operations.

In addition, we receive and maintain certain personal information about our customers and employees. The use of this information by us is regulated by applicable law. If our security and information systems are compromised or our employees fail to comply with these laws and regulations and this information is obtained by unauthorized persons or used inappropriately, it could adversely affect our reputation, financial condition and results of operations. Additionally, we could be subject to litigation or the imposition of penalties. As privacy and information security laws and regulations change, we may incur additional costs to ensure we remain in compliance.

Risks related to our stock

The market price of our common stock has been volatile and may continue to be volatile, and you may not be able to sell our stock at a favorable price or at all.

The market price of our common stock is likely to fluctuate significantly from time to time in response to a number of factors, most of which we cannot control, including those described under "—Risks related to our business" and the following:

differences between our actual financial and operating results and those expected by investors;

fluctuations in our quarterly operating results;

market conditions in our industry and the economy as a whole;

changes in our earnings guidance;

a change in the recommendation by any research analyst that follows our stock or any failure to meet the estimates made by research analysts;

investor perceptions of our prospects and the prospects of the grocery and dietary supplement industries;

the performance of our key vendors;

announcements by us, our vendors or our competitors regarding performance, strategy, significant acquisitions, divestitures, strategic partnerships, joint ventures or capital commitments;

introductions of new product or new pricing policies by us or our competitors;

failure to recruit or retain key personnel; and

the level and quality of securities research analyst coverage for our common stock.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market price of equity securities.

Our current principal stockholders have significant influence over us, and they could delay, deter or prevent a change of control or other business combination or otherwise cause us to take action with which you might not agree.

Members of the Isely family and certain persons, entities and accounts subject to a stockholders agreement relating to voting and limitations on the sale of shares, own or control 57.3% of our common stock. Due to their holdings of common stock, members of the Isely family are able to continue to determine the outcome of virtually all matters submitted to stockholders for approval, including the election of directors, an amendment of our certificate of incorporation (except when a class vote is required by law), any merger or consolidation requiring common stockholder approval, and a sale of all or substantially all of the Company's assets. Members of the Isely family have the ability to prevent change-in-control transactions as long as they maintain voting control of the Company. In addition, members of the Isely family and trusts controlled by them entered into a stockholders agreement by which they agreed to aggregate their voting power with regard to the election of directors.

In addition, because these holders have the ability to elect all of our directors, they are able to control our policies and operations, including the appointment of management, future issuances of our common stock or other securities, the payments of dividends on our common stock and entering into extraordinary transactions, and their interests may not in all cases be aligned with your interests.

A substantial number of shares of our common stock are eligible for sale, and their sale could adversely affect our stock price and could impair our ability to raise capital through the sale of equity securities.

If certain of our stockholders sell, or the market perceives that certain of our stockholders intend to sell, in the public market, substantial amounts of our common stock, the market price of our common stock could decline significantly. These sales also might make it more difficult for us to sell equity or equity related securities in the future at a time and price we deem appropriate. As of December 8, 2014 we had a total of 22,487,600 shares of common stock outstanding. Of those, the 8,214,285 shares of common stock issued in the IPO and the 271,552 shares that as of December 8, 2014 had been issued in connection with the vesting of restricted stock units issued under the 2012 Omnibus Incentive Plan, are registered and freely tradable without restriction under the Securities Act. The Company is aware that 34,947 shares have been sold, and believes approximately 440,000 additional shares could be sold, in exempt transactions. Up to approximately 13,526,816 additional shares of common stock could be sold, subject to compliance with the requirements of the Securities Act and the stockholders agreement among members of the Isely family and certain persons, entities and accounts. The market price of our common stock could drop significantly if the holders of restricted shares sell them or are perceived by the market as intending to sell them. Also, in the future, we may issue shares of our common stock as a result of the vesting of up to 49,181 additional restricted stock units or in connection with investments or acquisitions. The number of shares of our common stock issued in connection with an investment or acquisition could constitute a material portion of our then outstanding shares of our common stock.

We do not anticipate paying dividends on our capital stock in the foreseeable future and capital appreciation may be your sole source of potential gain.

We anticipate that we will retain our future earnings, for the foreseeable future, in order to fund our growth strategy and for general corporate purposes. The declaration and payment of future dividends to holders of our common stock will be at the discretion of our board of directors (our board) and will depend upon many factors, including our financial condition, earnings, legal requirements, restrictions in our debt agreements and other factors our board deems relevant. As a result, we can make no assurance that we will pay cash dividends to our stockholders in the future. Capital appreciation, if any, of our common stock will be your sole source of potential gain for the foreseeable future.

If securities or industry analysts do not publish research or reports about our business, if they adversely change their recommendations regarding our stock or if our operating results do not meet their expectations, our stock price could decline.

The trading market for our common stock is influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of these analysts cease to cover our company or fail to publish reports on us regularly, we may lose visibility in the financial markets, which could cause our stock price or trading volume to decline. Moreover, if one or more of the analysts who cover our company downgrades our stock, or if our operating results do not meet their expectations, our stock price could decline.

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Anti-takeover provisions in our organizational documents and Delaware law may discourage or prevent a change in control, even if a sale of the Company would be beneficial to our stockholders, which could cause our stock price to decline and prevent attempts by our stockholders to replace or remove our current management.

Several provisions of our certificate of incorporation and amended and restated bylaws could make it difficult for our stockholders to change the composition of our board, preventing them from changing the composition of management. In addition, the same provisions may discourage, delay or prevent a merger or acquisition that our stockholders may consider favorable.

These provisions include:

- a staggered, or classified, board of directors;
- authorizing our board to issue “blank check” preferred stock without stockholder approval;
- prohibiting cumulative voting in the election of directors;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholders from acting by written consent after the Isely family ceases to own more than 50% of the total voting power of our shares; and
- establishing advance notice requirements for nominations for election to our board or for proposing matters that can be acted on by stockholders at stockholder meetings.

These anti-takeover provisions could substantially impede the ability of our common stockholders to benefit from a change in control and, as a result, could materially adversely affect the market price of our common stock and your ability to realize any potential change-in-control premium.

We are a “controlled company” within the meaning of the NYSE Listed Company Manual, and, as a result, rely on exemptions from certain corporate governance requirements that provide protection to stockholders of other companies.

The Isely family, or entities controlled by the Isely family, own more than 50% of the total voting power of our common shares for the election of directors, and therefore, we are considered a “controlled company” under the corporate governance standards set forth in the NYSE Listed Company Manual. As a “controlled company,” certain exemptions under NYSE standards free us from the obligation to comply with certain corporate governance requirements of the NYSE, including the requirements:

- that a majority of our board consists of “independent directors,” as defined under the rules of the NYSE;

- that our director nominees be selected, or recommended for our boards’ selection, either (1) by a majority of independent directors in a vote by independent directors, pursuant to a nominations process adopted by a board resolution, or (2) by a nominating and governance committee composed solely of independent directors with a written charter addressing the nominations process; and

- that the compensation of our executive officers be determined, or recommended to the board for determination, by a majority of independent directors in a vote by independent directors, or a compensation committee composed solely of independent directors.

Accordingly, for so long as we are a “controlled company,” you will not have the same protections afforded to stockholders of companies that are subject to all of the NYSE corporate governance requirements.

Our costs have increased significantly as a result of operating as a public company, and our management is required to devote substantial time to complying with public company regulations.

Prior to our IPO in fiscal year 2012, we operated our business as a private company. As a public company, we have incurred and will further incur additional legal, accounting, compliance and other expenses that we did not incur as a private company. We are obligated to file with the SEC annual and quarterly reports and other reports that are specified in Section 13 and other sections of the Securities Exchange Act of 1934, as amended (Exchange Act). In addition, we have, and may in the future, become subject to other reporting and corporate governance requirements, including certain requirements of the NYSE, and certain provisions of Sarbanes-Oxley and the Dodd-Frank Wall Street Reform and Consumer Protection Act, (Dodd-Frank), which are imposing or will impose significant compliance obligations upon us.

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Sarbanes-Oxley and Dodd-Frank, as well as rules subsequently implemented by the SEC and the NYSE, have imposed enhanced corporate governance and disclosure practices for public companies. Our efforts to comply with evolving laws, regulations and standards in this regard have resulted and are likely to continue to result in increased administrative expenses and a diversion of management’s time and attention from revenue generating activities to compliance activities. These changes have required and are likely to continue to require a significant commitment of additional capital and resources. We may not be successful in implementing these requirements, and implementing them could materially adversely affect our business, results of operations and financial condition. In addition, if we fail to implement the requirements with respect to our internal accounting and audit functions, our ability to report our operating results on a timely and accurate basis could be impaired. If we do not implement such requirements in a timely manner or with adequate compliance, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC or the NYSE. Any such action could harm our reputation and the confidence of investors and customers in our company and materially adversely affect our business and cause our share price to fall.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

As of September 30, 2014, we had 87 stores located in 14 states, as shown in the chart below:

State	**Number of Stores**
Arizona	3
Colorado	32
Idaho	3
Kansas	6
Missouri	1
Montana	4
Nebraska	3
New Mexico	5
Oklahoma	4
Oregon	8
Texas	13
Utah	2
Washington	1
Wyoming	2

In the fiscal years ended September 30, 2014 and 2013, we opened 15 and 13 new stores, respectively. During fiscal year 2015, through the date of this report, we have opened four stores in Golden, Colorado, Independence, Missouri, Reno, Nevada, and Oklahoma City, Oklahoma. We have signed leases for an additional five of the 18 new stores expected to open in fiscal year 2015.

Our home office is located in Lakewood, Colorado. We occupy our home office under a lease for approximately 35,000 square feet that expires in 2026; this facility is co-located with one of our stores. Additionally, we have a bulk food repackaging facility and distribution center located in Golden, Colorado.

All of our stores and facilities are leased, with varying terms and renewal options. Lease terms typically range between ten and 20 years, with additional renewal options. We do not believe that any individual store property is material to our financial condition or results of operations. Of the current leases for our stores, one expires in fiscal year 2015, six expire in fiscal year 2016, one expires in fiscal year 2017, four expire in fiscal year 2018, and the remainder will expire between fiscal years 2019 and 2062. We expect that we will be able to renegotiate these leases or relocate these stores as necessary.

In addition to new store openings, we periodically remodel or relocate stores. For fiscal year 2015, we plan to relocate three stores and remodel two stores.

Item 3. Legal Proceedings.

We periodically are involved in various legal proceedings that are incidental to the conduct of our 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, 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. Although we cannot predict with certainty the ultimate resolution of any lawsuits, investigations and claims asserted against us, we do not believe 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 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market Information

Our common stock has traded on the NYSE under the symbol "NGVC" since July 25, 2012, following the pricing of our IPO. Prior to that date, there was no public market for our common stock.

Price Range of Our Common Stock

The following table shows the high and low sale prices per share of our common stock as quoted by the NYSE for the periods indicated:

Year ended September 30, 2014	High	Low
First Quarter (October 1, 2013 – December 31, 2013)	$42.68	$34.47
Second Quarter (January 1, 2014 – March 31, 2014)	44.60	33.51
Third Quarter (April 1, 2014 – June 30, 2014)	44.00	18.95
Fourth Quarter (July 1, 2014 – September 30, 2014)	24.27	16.01

Year ended September 30, 2013	High	Low
First Quarter (October 1, 2012 – December 31, 2012)	$25.00	$17.45
Second Quarter (January 1, 2013 – March 31, 2013)	23.45	17.47
Third Quarter (April 1, 2013 – June 30, 2013)	34.34	21.00
Fourth Quarter (July 1, 2013 – September 30, 2013)	42.86	29.24

Holders of Record

As of September 30, 2014, there were 102 holders of record of our common stock, and the closing price of our common stock was $16.28.

Dividend Policy

We anticipate that we will retain our future earnings, for the foreseeable future, in order to fund our growth strategy and for general corporate purposes. The declaration and payment of future dividends to holders of our common stock will be at the discretion of our board and will depend upon many factors, including our financial condition, earnings, legal requirements, and restrictions in our debt agreements and other factors our board deems relevant. Additionally, our Credit Facility prohibits the payment of cash dividends to Natural Grocers by Vitamin Cottage, Inc., the holding company, from Vitamin Cottage Natural Food Markets, Inc., the operating company, without the administrative agent's consent except when no default or event of default exists. If no default or event of default exists, dividends are allowed for various audit, accounting, tax, securities, indemnification, reimbursement, insurance and other reasonable expenses in the ordinary course of business.

Performance Graph

The graph below compares the cumulative return to shareholders of our common stock relative to the cumulative total returns of the NYSE Composite Index and the S&P Food Retail Index from July 25, 2012 to September 30, 2014, which is the amount of time our stock has been trading publicly following our IPO on July 25, 2012. The graph tracks the performance of a $100 investment in our common stock and in each of the indexes from July 25, 2012 to September 30, 2014. The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Use of Proceeds From Registered Securities

None.

Unregistered Sales of Equity Securities

None.

Issuer Purchases of Equity Securities

None.

Item 6. Selected Financial Data.

The following selected financial data presented below is derived from the Company’s consolidated financial statements and should be read in conjunction with “Item 1A. Risk Factors,” “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Item 8. Financial Statements and Supplementary Data.” Our historical results set forth below are not necessarily indicative of results to be expected for any future period.

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	Year ended September 30, 2014	2013	2012	2011	2010
Statements of Income Data (*dollars in thousands*):					
Net sales	$520,674	430,655	336,385	264,544	226,910
Cost of goods sold and occupancy costs	369,172	304,922	237,328	187,162	159,797
Gross profit	151,502	125,733	99,057	77,382	67,113
Store expenses	108,657	89,935	72,157	57,610	47,162
Administrative expenses	14,823	13,479	12,733	10,397	9,631
Pre-opening and relocation expenses	3,774	3,231	2,173	1,964	1,293
Operating income	24,248	19,088	11,994	7,411	9,027
Other income (expense):					
Interest expense	(2,496)	(2,166)	(568)	(669)	(967)
Other income (expense), net	2	9	6	35	3
Income before income taxes	21,754	16,931	11,432	6,777	8,063
Provision for income taxes	(8,281)	(6,379)	(3,955)	(2,167)	(2,466)
Net income	13,473	10,552	7,477	4,610	5,597
Net income attributable to noncontrolling interest	—	—	(828)	(1,106)	(1,189)
Net income attributable to Natural Grocers by Vitamin Cottage, Inc.	$13,473	10,552	6,649	3,504	4,408
Per Share Data:					
Net income attributable to Natural Grocers by Vitamin Cottage, Inc. per common share					
Basic	$0.60	0.47	0.30	0.16	0.20
Diluted	$0.60	0.47	0.30	0.16	0.20
Shares used in computation of net income attributable to Natural Grocers by Vitamin Cottage, Inc. per common share					
Basic	22,466,432	22,399,346	22,372,184	22,372,184	22,372,184
Diluted	22,479,835	22,441,382	22,463,093	22,461,405	22,461,405
Pro Forma Statements of Income Data (Unaudited) (*dollars in thousands*)(1):					
Income before income taxes	$21,754	16,931	11,432	6,777	8,063
Pro forma provision for income taxes	(8,281)	(6,379)	(4,264)	(2,589)	(2,892)
Pro forma net income	$13,473	10,552	7,168	4,188	5,171
Pro Forma Per Share Data (Unaudited)(2):					
Pro forma net income per common share					
Basic	$0.60	0.47	0.32	0.19	0.23
Diluted	$0.60	0.47	0.32	0.19	0.23
Other Financial Data (Unaudited) (*dollars in thousands*):					
EBITDA(3)	$41,462	32,593	21,949	15,137	14,540
EBITDA margin(4)	8.0 %	7.6	6.5	5.7	6.4
Other Operating Data (Unaudited):					
Number of stores at end of period	87	72	59	49	39

Number of stores opened during the period	15		13	10	10	6
Number of stores relocated and remodeled during the period	2		3	1	1	2
Change in comparable store sales(5)	5.6	%	10.8	11.6	4.9	2.1
Change in daily average comparable store sales(5)	5.6	%	11.1	11.3	4.9	2.1
Change in mature store sales(6)	3.4	%	6.1	7.6	2.0	0.2
Change in daily average mature store sales(6)	3.4	%	6.4	7.3	2.0	0.2
Gross square footage at end of period(7)	1,354.204		1,097,708	801,914	619,172	472,393
Selling square footage at end of period(7)	892,908		728,609	572,132	459,435	360,764
Average comparable store size (gross square feet)(8)	15,250		13,900	12,816	12,239	12,328
Average comparable store size (selling square feet)(8)	10,125		9,872	9,458	9,284	9,483
Comparable store sales per selling square foot during period(9)	$708		729	734	720	730

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	As of September 30,				
	2014	2013	2012	2011	2010
Selected Balance Sheet Data (*dollars in thousands*):					
Cash and cash equivalents	$5,113	8,132	17,291	378	446
Total assets	188,985	159,903	125,662	78,915	60,272
Total debt(10)	21,977	19,822	5,808	28,442	23,748
Total stockholders' equity	98,854	84,533	72,949	15,927	12,307

(1) In connection with our IPO in the fourth quarter of fiscal year 2012, we purchased the 45% noncontrolling interest in Boulder Vitamin Cottage Group, LLC (BVC) not previously owned by us. Prior to the purchase of the noncontrolling interest, we held a controlling 55% interest in BVC for all periods presented. As such, our consolidated statements of income include the revenues and expenses of BVC for the fiscal years ended September 30, 2012, 2011 and 2010 as required by generally accepted accounting principles in the United States of America (GAAP). We previously reported the 45% of BVC's net income as net income attributable to noncontrolling interest in our consolidated statements of income for the periods in which we did not own 100% of BVC. The pro forma financial data presented above illustrates what our net income would have been had we owned 100% of BVC for the fiscal years ended September 30, 2012, 2011 and 2010. Pro forma net income attributable to Natural Grocers by Vitamin Cottage, Inc., is not a measure of financial performance under GAAP. Management believes that investors' understanding of our performance is enhanced by including this non-GAAP financial measure of pro forma net income, together with a reconciliation from net income attributable to Natural Grocers by Vitamin Cottage, Inc., as a reasonable basis for comparing our ongoing results of operations. Many investors are interested in understanding the performance of our business by comparing our results from ongoing operations period over period, and we believe this non-GAAP measure provides investors with comparable data period over period to illustrate pro forma results had we owned 100% of BVC for all periods presented. We further believe that our presentation of this non-GAAP financial measurement provides information that is useful to analysts and investors because they are important indicators of the strength of our operations and the performance of our business. This non-GAAP measure 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. This non-GAAP financial measure has limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP.

The following table reconciles net income attributable to Natural Grocers by Vitamin Cottage, Inc. to pro forma net income, dollars in thousands, except per share data:

	Year ended September 30,				
	2014	2013	2012	2011	2010
Net income attributable to Natural Grocers by Vitamin Cottage, Inc.	$13,473	10,552	6,649	3,504	4,408
Net income attributable to noncontrolling interest	—	—	828	1,106	1,189
Net income	13,473	10,552	7,477	4,610	5,597
Provision for income taxes	8,281	6,379	3,955	2,167	2,466
Income before income taxes	21,754	16,931	11,432	6,777	8,063
Pro forma provision for income taxes	(8,281)	(6,379	(4,264)	(2,589	(2,892)

		)		)	
Pro forma net income	$13,473	10,552	7,168	4,188	5,171

Per Share Data:

Pro forma net income per common share					
Basic	$0.60	0.47	0.32	0.19	0.23
Diluted	$0.60	0.47	0.32	0.19	0.23

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Our effective tax rate increased as a result of the BVC acquisition, as the income attributable to the noncontrolling interest was nontaxable income prior to the acquisition, but is included in our taxable income after the acquisition. The following table reconciles our effective tax rate to our pro forma effective tax rate had we owned 100% of BVC for the fiscal years ended September 30, 2012, 2011 and 2010:

	Year ended September 30,				
	2014	**2013**	**2012**	**2011**	**2010**
Statutory tax rate	35.0 %	34.0	34.0	34.0	34.0
Nontaxable net income attributable to noncontrolling interest	—	—	(2.7)	(6.2)	(5.3)
State income taxes, net of federal income tax expense	3.0	3.3	3.0	3.4	2.5
Other, net	0.1	0.4	0.3	0.8	(0.6)
Effective tax rate	38.1	37.7	34.6	32.0	30.6
Pro forma adjustment to exclude nontaxable net income attributable to noncontrolling interest	—	—	2.7	6.2	5.3
Pro forma effective tax rate	38.1 %	37.7	37.3	38.2	35.9

Effective October 31, 2012, BVC merged with and into our operating company and ceased to exist.

(2) Pro forma per share data is calculated using pro forma net income had we owned 100% of BVC for the fiscal years ended September 30, 2012, 2011 and 2010, as discussed above, divided by basic and diluted weighted average shares outstanding for those fiscal periods.

(3) Earnings before interest, taxes, depreciation and amortization, (EBITDA) is not a measure of financial performance under GAAP. We define EBITDA as net income attributable to Natural Grocers by Vitamin Cottage, Inc. before interest expense, provision for income tax, depreciation and amortization, and for the fiscal years ended September 30, 2012, 2011 and 2010, net income attributable to the noncontrolling interest. 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 measure in our debt covenants under our Credit Facility. In addition, EBITDA performance is one of the factors upon which funding of our incentive compensation plans is based.

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 attributable to Natural Grocers by Vitamin Cottage, Inc., we believe we are enhancing investors’ understanding of our business and our results of operations, as well as assisting 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 EBITDA 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 our consolidated financial statements as indicators of financial performance. EBITDA has limitations as an analytical tool, and should not be considered in isolation, 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;

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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. We further believe that our presentation of this non-GAAP financial measurement provides information that is useful to analysts and investors because it is an important indicator of the strength of our operations and the performance of our business.

The following table reconciles net income attributable to Natural Grocers by Vitamin Cottage, Inc. to EBITDA, dollars in thousands:

	Year ended September 30,				
	2014	**2013**	**2012**	**2011**	**2010**
Net income attributable to Natural Grocers by Vitamin Cottage, Inc.	$13,473	10,552	6,649	3,504	4,408
Net income attributable to noncontrolling interest	—	—	828	1,106	1,189
Net income	13,473	10,552	7,477	4,610	5,597
Interest expense	2,496	2,166	568	669	967
Provision for income taxes	8,281	6,379	3,955	2,167	2,466
Depreciation and amortization	17,212	13,496	9,949	7,691	5,510
EBITDA	$41,462	32,593	21,949	15,137	14,540

(4) EBITDA margin is defined as the ratio of EBITDA to net sales. We present EBITDA margin because it is used by management as a performance measurement of EBITDA generated from net sales. See footnote (3) above for a discussion of EBITDA as a non-GAAP financial measure and a reconciliation of net income to EBITDA.

(5)

When calculating change in comparable store sales, we begin to include sales from a store in our comparable store base 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. When calculating daily average comparable store sales, we include the 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.

(6) When calculating change in mature store sales, we begin to include sales from a store in our mature store base after the store has been open for any part of five fiscal years (for example, our mature stores for fiscal year 2014 are stores that opened during or before fiscal year 2009). 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. When calculating daily average mature store sales, we include the 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 we are open during the comparable periods.

(7) Gross square footage and selling square footage at the end of the period include the square footage for all stores that were open as of the end of the period presented.

(8) Average comparable store size for gross square feet and selling square feet are calculated using the average store size for all stores that were in the comparable store base as of the end of the period presented.

(9) Comparable store sales per selling square foot is calculated using comparable store sales for the period divided by the weighted average selling square feet per store based on the amount of time the store was included in the comparable store base during the period.

(10) Total debt includes capital and financing lease obligations, notes payable to related parties, the outstanding principal balance of our term loan and outstanding borrowings under our Credit Facility. As of September 30, 2012, the term loan was fully repaid. As of September 30, 2013, the notes payable to related parties was fully repaid. As of both September 30, 2014 and September 30, 2013, no amounts were outstanding under our Credit Facility.

Item 7. 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 consolidated financial statements and notes thereto and "Selected Financial Data," which are included elsewhere in this report on Form 10-K. This discussion and analysis contains forward-looking statements. Refer to "*Forward-Looking Statements*" at the beginning of this report on Form 10-K 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 2014" refers to the year from October 1, 2013 to September 30, 2014). 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 believe we have been at the forefront of the natural and organic foods movement since our founding. We are headquartered in Lakewood, Colorado, and as of September 30, 2014, we operated 87 stores in 14 states, including Colorado, Arizona, Idaho, Kansas, Missouri, Montana, Nebraska, New Mexico, Oklahoma, Oregon, Texas, Utah, Washington and Wyoming, as well as a bulk food repackaging facility and distribution center in Colorado.

We offer a variety of natural and organic groceries and dietary supplements that meet our strict quality guidelines. The size of our stores varies from 5,000 to 16,000 selling square feet. For the year ended September 30, 2014, 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. Over the last five fiscal years, our store base has grown at a compound annual growth rate of 21.4%, including 15, 13 and ten new stores in fiscal year 2014, 2013 and 2012, respectively. We currently plan to open 18 new stores in fiscal year 2015. Between September 30, 2014 and the date of this report on Form 10-K, we have opened four stores in Colorado, Missouri, Nevada and Oklahoma. As of the date of this report, we also have signed leases for an additional five new store locations expected to open in fiscal year 2015 in Arizona, Arkansas, Colorado and Kansas.

Performance Highlights

Key highlights of our recent performance are discussed briefly below and are discussed 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 $520.7 million for the year ended September 30, 2014, which is a $90.0 million, or 20.9%, increase compared to net sales of $430.7 million for the year ended September 30, 2013. Net sales increased at a compound annual growth rate of 24.4% from fiscal year 2012 to fiscal year 2014.

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Comparable store sales and daily average comparable store sales. Comparable store sales and daily average comparable store sales for the year ended September 30, 2014 each increased 5.6% over the year ended September 30, 2013. As of September 30, 2014, we have had over 49 consecutive quarters of positive comparable store sales growth.

Mature store sales and daily average mature store sales. Mature store sales and daily average mature store sales for the year ended September 30, 2014 each increased 3.4% over the year ended September 30, 2013. For fiscal year 2014, mature stores include all stores open during or before fiscal year 2009.

Net income. Net income was $13.5 million for the year ended September 30, 2014, which increased $2.9 million, or 27.7%, when compared to net income of $10.6 million for the year ended September 30, 2013.

EBITDA. EBITDA was $41.5 million in the year ended September 30, 2014, which increased $8.9 million, or 27.2%, from $32.6 million in the year ended September 30, 2013. EBITDA is not a measure of financial performance under GAAP. Refer to the "Selected Financial Data" section of this report on Form 10-K for a definition of EBITDA and a reconciliation of net income attributable to Natural Grocers by Vitamin Cottage, Inc. to EBITDA.

Liquidity. As of September 30, 2014, cash and cash equivalents was $5.1 million, and there was $14.3 million available under our Credit Facility of $15.0 million. As of September 30, 2014, the Company had an outstanding letter of credit of $0.7 million which was reserved against the amount available for borrowing under the terms of our Credit Facility. The Company had no amounts outstanding under our Credit Facility as of September 30, 2014.

New store growth. We have opened 54 new stores since the beginning of fiscal year 2010, ending with 87 stores as of September 30, 2014. Our new store compound annual growth rate was 21.4% from fiscal year 2012 to fiscal year 2014.

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, economic conditions, the level of disposable consumer income, consumer debt, interest rates, the price of commodities, the political environment and consumer confidence.

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 continued 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 after its opening date. 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 continuing into the foreseeable future. Our financial results for the year ended September 30, 2014 reflect the effects of these factors, and we anticipate future periods will be impacted likewise.

Competition. The grocery and dietary supplement retail business is a large, fragmented and highly competitive industry. Our competition varies by market and includes conventional supermarkets, natural, gourmet and specialty food markets, mass and discount retailers, warehouse clubs, independent health food stores, dietary supplement retailers, drug stores, farmers markets, food co-ops, mail order and online retailers and multi-level marketers. We have recently faced increased competition as a result of the opening of natural and organic, gourmet and/or specialty food retailers, as well as the increased offering of natural and organic foods at conventional grocers. In some cases, the impact of these competitive changes has caused the rate of growth in our net sales to decelerate. The longer term impact is more difficult to predict and is dependent on a number of factors in a particular market. 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 exceptional customer service and operational excellence, differentiate us in the industry and provide us the competitive advantage to effectively respond to the increased competition.

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Outlook

We believe there are several key factors that have contributed to our success and will enable us to continue to expand profitably and increase our comparable store sales, including a loyal customer base, increasing basket size, 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 at or above recent levels of growth. During the past few years, we have successfully expanded our infrastructure to enable us to support our continued growth. This has included successfully implementing our ERP system, hiring key personnel and developing efficient, effective new store opening construction and operations processes and relocating and expanding our bulk food repackaging facility and distribution center. We substantially completed the implementation of a HRIS in fiscal year 2014 which we believe will allow us to more efficiently and effectively onboard and train our employees at all locations. In fiscal year 2015, we plan to redesign our website to enhance functionality and create a more engaging user experience, as well as exploring options to include additional services through other digital platforms, such as digital coupons, home delivery services and a loyalty program.

We believe there are opportunities for us to continue to expand our store base and focus on increasing comparable store sales. Future sales growth, including comparable store sales, could vary due to increasingly competitive conditions in the natural and organic grocery and dietary supplement industry. 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.

Our operating results may be affected by a variety of internal and external factors and trends described more fully in the section “Risk Factors” contained elsewhere in this report on Form 10-K.

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, 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.

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. The years ended September 30, 2014 and 2013 each had one less selling day than the year ended September 30, 2012 due to the occurrence of leap year in the year ended September 30, 2012.

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 2014 are stores that opened during or before fiscal year 2009). 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.

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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. The years ended September 30, 2014 and 2013 each had one less selling day than the year ended September 30, 2012 due to the occurrence of leap year in the year ended September 30, 2012.

Transaction count. Transaction count represents the number of transactions reported at our stores over such 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 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 report on Form 10-K 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. We do not record straight-line rent expense in cost of goods sold and occupancy costs for the leases classified as capital and financing lease obligations, but rather 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 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 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 majority of store expenses are comprised of salary related expenses which we closely manage and which trend closely with sales. 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.

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 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.

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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 or a capital or financing lease, as well as increases 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, net of capitalized interest. Interest expense also includes interest we incur on our outstanding indebtedness, which includes our Credit Facility and related party notes payable. As of September 30, 2012, our prior term loan was fully repaid. As of September 30, 2013, the notes payable to related parties were fully repaid. As of both September 30, 2014 and September 30, 2013, no amounts were outstanding under our Credit Facility.

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:

	Year ended September 30,		
	2014	**2013**	**2012**
Statements of Income Data:*			
Net sales	100.0 %	100.0	100.0
Cost of goods sold and occupancy costs	70.9	70.8	70.6
Gross profit	29.1	29.2	29.4
Store expenses	20.9	20.9	21.5
Administrative expenses	2.8	3.1	3.8
Pre-opening and relocation expenses	0.7	0.8	0.6
Operating income	4.7	4.4	3.6
Interest expense	(0.5)	(0.5)	(0.2)

Income before income taxes	4.2	3.9	3.4
Provision for income taxes	(1.6)	(1.5)	(1.2)
Net income	2.6	2.5	2.2
Net income attributable to noncontrolling interest	—	—	(0.2)
Net income attributable to Natural Grocers by Vitamin Cottage, Inc.	2.6 %	2.5	2.0

**Figures may not sum due to rounding.*

Other Operating Data:

Number of stores at end of period	87	72	59
Store unit count increase period over period	20.8 %	22.0	20.4
Change in comparable store sales	5.6 %	10.8	11.6
Change in daily average comparable store sales	5.6 %	11.1	11.3
Change in mature store sales	3.4 %	6.1	7.6
Change in daily average mature store sales	3.4 %	6.4	7.3

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Year ended September 30, 2014 compared to the year ended September 30, 2013

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

	Year ended September 30,		Increase (Decrease)	
	2014	**2013**	**Dollars**	**Percent**
Statements of Income Data:				
Net sales	$520,674	430,655	90,019	20.9 %
Cost of goods sold and occupancy costs	369,172	304,922	64,250	21.1
Gross profit	151,502	125,733	25,769	20.5
Store expenses	108,657	89,935	18,722	20.8
Administrative expenses	14,823	13,479	1,344	10.0
Pre-opening and relocation expenses	3,774	3,231	543	16.8
Operating income	24,248	19,088	5,160	27.0
Other income (expense):				
Dividends and interest income	2	9	(7)	(77.8)
Interest expense	(2,496)	(2,166)	(330)	15.2
Income before income taxes	21,754	16,931	4,823	28.5
Provision for income taxes	(8,281)	(6,379)	(1,902)	29.8
Net income	$13,473	10,552	2,921	27.7 %

Net sales

Net sales increased $90.0 million, or 20.9%, to $520.7 million for the year ended September 30, 2014 compared to $430.7 million for the year ended September 30, 2013 primarily due to a $66.0 million increase in new store sales and a $24.0 million, or 5.6%, increase in comparable store sales. The comparable store sales increase was driven by a 2.3% increase in daily average transaction count and a 3.2% increase in average transaction size. Comparable store average transaction size was $36.09 in the year ended September 30, 2014 compared to $35.96 in the year ended September 30, 2013. The rate of growth in our comparable store sales, while positive, has been slowed by the impact of increased competition.

Gross profit

Gross profit increased $25.8 million, or 20.5%, to $151.5 million for the year ended September 30, 2014 compared to $125.7 million for the year ended September 30, 2013 primarily driven by positive comparable store sales and an increase in the number of stores. Gross margin decreased to 29.1% for the year ended September 30, 2014 from 29.2% for the year ended September 30, 2013. The decrease in gross margin was due to an increase in occupancy costs as a percentage of sales, partially offset by an increase in product margin. The positive impact in product margin is due to increases in product margin across almost all departments, partially offset by a shift in sales mix towards products with lower margin for the year ended September 30, 2014 as compared to the year ended September 30, 2013. Gross margin benefitted from operating efficiencies at the bulk food repackaging and distribution center for the year ended September 30, 2014 as compared to the year ended September 30, 2013. Occupancy costs as a percentage of sales increased in the year ended September 30, 2014 as compared to the year ended September 30, 2013 primarily due to increased average lease expenses at newer stores and the fixed nature of occupancy costs per store.

For the years ended September 30, 2014 and 2013, the Company had ten and nine leases for stores which were classified as capital and financing lease obligations. 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 years ended September 30, 2014 and 2013 would have been approximately 60 and 55 basis points higher than as reported, respectively.

Store expenses

Store expenses increased $18.7 million, or 20.8%, to $108.7 million in the year ended September 30, 2014 from $89.9 million in the year ended September 30, 2013. Store expenses as a percentage of sales were 20.9% for both of the years ended September 30, 2014 and 2013. The consistency of store expenses as a percentage of sales was primarily due to an overall decrease in salaries, benefits and related expenses, offset by increases in depreciation expense and, to a lesser extent, utilities expense. The decreases in salaries, benefits and related expenses was primarily due to lower incentive compensation and other discretionary benefits expense, reflecting our pay-for-performance philosophy, partially offset by increases in salaries, benefits and related expenses required to support store growth. Salaries, benefits and related expense increased as a percentage of sales at comparable stores. Depreciation expense as a percentage of sales increased due to stores opened in fiscal year 2014.

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Administrative expenses

Administrative expenses increased $1.3 million, or 10.0%, to $14.8 million for the year ended September 30, 2014 compared to $13.5 million for the year ended September 30, 2013, primarily due to the addition of general and administrative positions to support our store growth, partially offset by lower incentive compensation and other discretionary benefits expense, reflecting our pay-for-performance philosophy. Administrative expenses as a percentage of sales were 2.8% and 3.1% for the years ended September 30, 2014 and 2013, respectively. The decrease in administrative expenses as a percentage of sales was a result of our ability to support additional store investment and sales without proportionate investments in overhead.

Pre-opening and relocation expenses

Pre-opening and relocation expenses increased $0.5 million, or 16.8%, in the year ended September 30, 2014 to $3.8 million compared to $3.2 million in the year ended September 30, 2013 due to the increased number of new store openings in fiscal year 2014, as well as the timing of new store openings and possession of stores that are not yet opened, and the lease classification for those stores that were opened. Pre-opening and relocation expenses as a percentage of sales were 0.7% and 0.8% for the years ended September 30, 2014 and 2013, respectively. The numbers of stores opened, relocated and remodeled were as follows for the periods presented:

	Year ended September 30,	
	2014	**2013**
New stores	15	13
Relocated stores		1
Remodeled stores	2	2
	17	16

Interest expense

Interest expense, net of capitalized interest, increased $0.3 million, or 15.2%, in the year ended September 30, 2014 compared to the year ended September 30, 2013 primarily due to a $0.7 million increase in interest expense primarily related to capital and financing lease obligations, offset by a $0.4 million increase in capitalized interest. If the capital and financing lease obligations had qualified as operating leases, interest expense as a percent of sales would have been approximately 45 and 50 basis points lower than as reported in the years ended September 30, 2014 and 2013, respectively.

Income taxes

Our effective income tax rate for the years ended September 30, 2014 and 2013 was 38.1% and 37.7%, respectively. The increase in our effective income tax rate was primarily due to an increase in federal income taxes, and to a lesser extent to changes in the blended state tax rates. Our federal income taxes increased because of additional taxable income and a consequential higher tax rate. Our additional taxable income was due in part to the impact of prior deductions for bonus depreciation.

During the first quarter of fiscal year 2014, the Company experienced benefits from the American Taxpayer Relief Act of 2012, which extended the 50% bonus depreciation on qualifying assets and the special 15 year life for qualified leasehold property and qualified retail improvement property for property acquired from January 1, 2013 through December 31, 2013. The Company does not anticipate future benefits from the American Taxpayer Relief Act of 2012 because its provisions expired as of December 31, 2013 and no precedent exists for it being retroactively reauthorized by Congress.

The Company also benefited from the extension of the Work Opportunity Tax Credit during the quarter ended December 31, 2013. Although the legislative authority for this credit expired December 31, 2013, the Company believes it may benefit from the credit in the future if Congress reauthorizes it.

Net income.

Net income increased 27.7% to $13.5 million, or $0.60 per diluted earnings per share, in the year ended September 30, 2014 from $10.6 million, or $0.47 per diluted earnings per share, in the year ended September 30, 2013.

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Year ended September 30, 2013 compared to the year ended September 30, 2012

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

	Year ended September 30,		Increase (Decrease)	
	2013	2012	Dollars	Percent
Statements of Income Data:				
Net sales	$430,655	336,385	94,270	28.0 %
Cost of goods sold and occupancy costs	304,922	237,328	67,594	28.5
Gross profit	125,733	99,057	26,676	26.9
Store expenses	89,935	72,157	17,778	24.6
Administrative expenses	13,479	12,733	746	5.9
Pre-opening and relocation expenses	3,231	2,173	1,058	48.7
Operating income	19,088	11,994	7,094	59.1
Other income (expense):				
Dividends and interest income	9	6	3	50.0
Interest expense	(2,166)	(568)	(1,598)	281.3
Income before income taxes	16,931	11,432	5,499	48.1
Provision for income taxes	(6,379)	(3,955)	(2,424)	61.3
Net income	10,552	7,477	3,075	41.1
Net income attributable to noncontrolling interest	—	(828)	828	(100.0)
Net income attributable to Natural Grocers by Vitamin Cottage, Inc.	$10,552	6,649	3,903	58.7 %

Net sales

Net sales increased $94.3 million, or 28.0%, to $430.7 million for the year ended September 30, 2013 compared to $336.4 million for the year ended September 30, 2012 primarily due to a $58.2 million increase in new store sales and a $36.1 million, or 10.8%, increase in comparable store sales. Daily average comparable store sales increased 11.1% for the year ended September 30, 2013 as compared to the year ended September 30, 2012. The daily average comparable store sales increase was primarily driven by a 5.9% increase in daily average transaction count and a 4.9% increase in average transaction size. Comparable store average transaction size was $35.96 in the year ended September 30, 2013 compared to $34.88 in the year ended September 30, 2012.

Gross profit

Gross profit increased $26.7 million, or 26.9%, to $125.7 million for the year ended September 30, 2013 compared to $99.1 million for the year ended September 30, 2012 primarily driven by positive comparable store sales and new store growth. Gross margin decreased to 29.2% for the year ended September 30, 2013 from 29.4% for the year ended September 30, 2012 due to a shift in sales mix toward products with lower margins, partially offset by purchasing improvements. Additionally, there was a decrease in product margin for bulk products due to increased production costs as a result of the relocation to a larger bulk food repackaging and distribution center in September 2012. Occupancy costs as a percentage of sales for the year ended September 30, 2013 remained flat as compared to the year ended September 30, 2012. For the year ended September 30, 2013, the Company had nine leases for stores which were classified as capital and financing lease obligations, one of which was under construction as of September 30, 2013 and opened in the first quarter of fiscal year 2014. For the year ended September 30, 2012, the Company had four leases for stores which were classified as capital and financing lease obligations, two of which were opened in the fourth quarter of fiscal year 2012 and two of which were under construction as of September 30, 2012 and opened in the first quarter of fiscal year 2013. If these leases had qualified as operating leases, the straight-line expense would have been included in occupancy costs, and our costs of goods sold and occupancy costs as a percentage of sales during the year ended September 30, 2013 would have been approximately 55 basis points higher than as reported.

Store expenses

Store expenses increased $17.8 million, or 24.6%, to $89.9 million in the year ended September 30, 2013 from $72.2 million in the year ended September 30, 2012. Store expenses as a percentage of sales were 20.9% and 21.5% for the years ended September 30, 2013 and 2012, respectively. The decrease in store expenses as a percentage of sales was primarily due to a decrease in salary related expenses as a percentage of sales, due to leverage from the increase in sales, as the increased salary related expenses required to support the sales growth was less than the increase in sales. Advertising and other expense as a percentage of sales decreased in fiscal year 2013 as compared to fiscal year 2012 due to leverage from the increase in sales, partially offset by an increase in depreciation expense as a percentage of sales.

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Administrative expenses

Administrative expenses increased $0.7 million, or 5.9%, to $13.5 million for the year ended September 30, 2013 compared to the year ended September 30, 2012, primarily due to the increased costs as a result of being a public company for a full year in fiscal year 2013, including $0.1 million of share-based compensation expense for shares issued to members of our Board of Directors, and the addition of general and administrative positions to support our store growth. Additionally, administrative expenses include $0.3 million and $1.4 million in share-based and IPO incentive compensation expense in the years ended September 30, 2013 and 2012, respectively, associated with awards granted in fiscal year 2012 related to our IPO and the portion of subsequent awards to certain employees who are not named executive officers that were issued in the fourth quarter of fiscal year 2013. Administrative expenses as a percentage of sales were 3.1% and 3.8% for the years ended September 30, 2013 and 2012, respectively. Excluding share-based and IPO incentive compensation expenses noted above, exclusive of the share-based compensation expense for shares issued to members of our Board of Directors, administrative expenses as a percentage of sales were 3.1% and 3.4% for the years ended September 30, 2013 and 2012, respectively. The decrease in administrative expenses as a percentage of sales was a result of our ability to support additional store investments and sales without proportionate investments in overhead.

Pre-opening and relocation expenses

Pre-opening and relocation expenses increased $1.1 million, or 48.7%, in the year ended September 30, 2013 to $3.2 million compared to the prior year due to the increased number of new store openings in fiscal year 2013, as well as the timing of new store openings and increased per-store expenses, due to the Company entering into more expensive leases. Pre-opening and relocation expenses as a percentage of sales were 0.8% and 0.6% for the years ended September 30, 2013 and 2012, respectively. The numbers of stores opened, relocated and remodeled were as follows for the periods presented:

	Year ended September 30,	
	2013	**2012**
New stores	13	10
Relocated stores	1	1
Remodeled stores	2	—
	16	11

Interest expense

Interest expense increased $1.6 million, or 281.3%, in the year ended September 30, 2013 compared to the year ended September 30, 2012 primarily due to a $2.1 million increase in interest expense related to capital and financing lease obligations, partially offset by a $0.5 million decrease in interest expense due to the payoff of all outstanding amounts under a term loan and revolving credit facility in July 2012 in conjunction with our IPO. If the capital and financing lease obligations had qualified as operating leases, interest expense as a percent of sales in the year ended September 30, 2013 would have been approximately 50 basis points lower than as reported.

Income taxes

Our effective income tax rate for the years ended September 30, 2013 and 2012 was 37.7% and 34.6%, respectively. The increase in our effective income tax rate was due in part to changes in the blended state tax rates. In addition, due to the purchase of BVC at the time of the IPO in fiscal year 2012, the Company no longer has net income attributable to noncontrolling interest. Excluding the impact of BVC for fiscal year 2012, our tax rate for the year ended September 30, 2013 remained relatively consistent with the year ended September 30, 2012.

Net income attributable to noncontrolling interest

Net income attributable to noncontrolling interest decreased $0.8 million to zero for the year ended September 30, 2013 as compared to the year ended September 30, 2012, due to the purchase of the remaining noncontrolling interest in BVC in July 2012. As a result of the purchase, we acquired 100% of the equity interest in BVC. Effective October 31, 2012, BVC merged with and into our operating company and ceased to exist.

Net income attributable to Natural Grocers by Vitamin Cottage, Inc.

Net income attributable to Natural Grocers by Vitamin Cottage, Inc. increased 58.7% to $10.6 million, or $0.47 per diluted earnings per share, in the year ended September 30, 2013 from $6.6 million, or $0.30 per diluted earnings per share, in the year ended September 30, 2012.

In connection with our IPO in the fourth quarter of fiscal year 2012, we purchased the 45% noncontrolling interest in BVC not previously owned by us. Prior to the purchase of the noncontrolling interest, we held a controlling 55% interest in BVC. As such, our consolidated statements of income for the years ended September 30, 2012 and 2011 include the revenues and expenses of BVC as required by GAAP, with 45% of BVC's net income reported as net income attributable to noncontrolling interest in our consolidated statements of income for the years ended September 30, 2012 and 2011.

Non-GAAP financial measures

Pro forma net income and adjusted pro forma net income

Pro forma net income and adjusted pro forma net income are not measures of financial performance under GAAP. The pro forma net income presented illustrates what our net income would have been had we owned 100% of BVC for the full year ended September 30, 2012, and pro forma adjusted net income further excludes the after tax impact of share-based compensation expense for our Chief Financial Officer and certain employees who are not named executive officers and to exclude expenses that were contingent upon the completion of our IPO. The following table reconciles net income attributable to Natural Grocers by Vitamin Cottage, Inc. to pro forma net income and adjusted pro forma net income, dollars in thousands, except per share data:

	Year ended September 30,		
	2014	**2013**	**2012**
Net income attributable to Natural Grocers by Vitamin Cottage, Inc.	$13,473	10,552	6,649
Net income attributable to noncontrolling interest	—	—	828
Net income	13,473	10,552	7,477
Provision for income taxes	8,281	6,379	3,955
Income before income taxes	21,754	16,931	11,432
Pro forma provision for income taxes	(8,281)	(6,379)	(4,264)
Pro forma net income	13,473	10,552	7,168

Share-based compensation (excluding Board of Directors share-based compensation) of $376, $489 and $1,106, net of income taxes of $143, $184 and $412, respectively	233	305	694
IPO incentive compensation of $0, $0 and $286, net of income taxes of $0, $0 and $107, respectively	—	—	179
Adjusted pro form net income	$13,706	10,857	8,041
Per Share Data:			
Pro forma net income per common share			
Basic	$0.60	0.47	0.32
Diluted	$0.60	0.47	0.32
Adjusted pro forma net income per common share			
Basic	$0.61	0.48	0.36
Diluted	$0.61	0.48	0.36

On a comparative basis, pro forma net income increased 27.7% to $13.5 million, or $0.60 per diluted earnings per share for the year ended September 30, 2014 as compared to pro forma net income of $10.6 million, or $0.47 per diluted earnings per share for the year ended September 30, 2013. On a comparative basis, pro forma net income increased 47.2% to $10.6 million or $0.47 per diluted earnings per share for the year ended September 30, 2013 as compared to pro forma net income of $7.2 million, or $0.32 per diluted earnings per share for the year ended September 30, 2012. Our effective tax rate increased as a result of the BVC acquisition, as the income attributable to the noncontrolling interest was nontaxable income prior to the acquisition, but is included in our taxable income after the acquisition. On a comparative basis, adjusted pro forma net income increased 26.2% to $13.7 million, or $0.61 per diluted earnings per share for the year ended September 30, 2014 as compared to adjusted pro forma net income of $10.9 million, or $0.48 per diluted earnings per share for the year ended September 30, 2013. On a comparative basis, adjusted pro forma net income increased 35.0% to $10.9 million, or $0.48 per diluted earnings per share for the year ended September 30, 2013 as compared to adjusted pro forma net income of $8.0 million, or $0.36 per diluted earnings per share for the year ended September 30, 2012.

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Management believes that investors' understanding of our performance is enhanced by including these non-GAAP financial measures of pro forma net income and adjusted pro forma net income, together with a reconciliation from net income attributable to Natural Grocers by Vitamin Cottage, Inc., as a reasonable basis for comparing our ongoing results of operations. Many investors are interested in understanding the performance of our business by comparing our results from ongoing operations period over period, and we believe these non-GAAP measures provide investors w