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(Address of principal executive offices)

(303) 986-4600

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 (§232.405 of this chapter) 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 check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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

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

The number of shares of the registrant's common stock, \$0.001 par value, outstanding as of January 31, 2018 was 22,349,282.

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Natural Grocers by Vitamin Cottage, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period Ended December 31, 2017

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Except where the context otherwise requires or where otherwise indicated: (i) 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 and (ii) 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 2018” refers to the year from October 1, 2017 to September 30, 2018).

Forward-Looking Statements

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

The forward-looking statements contained in this Form 10-Q are based on management’s current expectations and are subject to uncertainty and changes in circumstances. We cannot assure you that future developments affecting us will be those that we have anticipated. Actual results may differ materially from these expectations due to changes in global, regional or local political, economic, business, competitive, market, regulatory and other factors, many of which are beyond our control. We believe that these factors include those referenced in Item 1A - “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 (the Form 10-K) and Item 1A – “Risk Factors” in this Form 10-Q. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, our actual results may vary in material respects from those projected in these forward-looking statements.

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

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

	December 31, 2017	September 30, 2017
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 8,089	6,521
Accounts receivable, net	4,477	4,860
Merchandise inventory	91,422	93,612
Prepaid expenses and other current assets	2,761	3,222
Total current assets	106,749	108,215
Property and equipment, net	185,189	184,417
Other assets:		
Deposits and other assets	1,688	1,642
Goodwill and other intangible assets, net of accumulated amortization of \$402 and \$394, respectively	5,673	5,655
Deferred financing costs, net	40	62
Total other assets	7,401	7,359
Total assets	\$ 299,339	299,991
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 52,163	56,849
Accrued expenses	17,177	14,164
Capital and financing lease obligations, current portion	604	548
Total current liabilities	69,944	71,561
Long-term liabilities:		

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Capital and financing lease obligations, net of current portion	37,120	32,880
Revolving credit facility	24,592	28,392
Deferred income tax liabilities	7,973	12,419
Deferred compensation	1,355	1,231
Deferred rent	10,593	10,465
Leasehold incentives	9,122	9,160
Total long-term liabilities	90,755	94,547
Total liabilities	160,699	166,108
Commitments (Note 6 and 11)		
Stockholders' equity:		
Common stock, \$0.001 par value, 50,000,000 shares authorized, 22,510,279 shares issued at December 31, 2017 and September 30, 2017, respectively, and 22,347,709 and 22,448,056 outstanding at December 31, 2017 and September 30, 2017, respectively	23	23
Additional paid-in capital	55,826	55,678
Retained earnings	84,026	78,846
Common stock in treasury at cost, 162,570 and 62,223 shares at December 31, 2017 and September 30, 2017, respectively	(1,235)	(664)
Total stockholders' equity	138,640	133,883
Total liabilities and stockholders' equity	\$ 299,339	299,991

See accompanying notes to unaudited interim consolidated financial statements.

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

	Three months ended December 31,	
	2017	2016
Net sales	\$202,480	183,577
Cost of goods sold and occupancy costs	149,321	131,424
Gross profit	53,159	52,153
Store expenses	45,166	41,843
Administrative expenses	5,257	4,883
Pre-opening and relocation expenses	543	1,261
Operating income	2,193	4,166
Interest expense	(1,089) (983)
Income before income taxes	1,104	3,183
Benefit from (provision for) income taxes	4,077	(1,122)
Net income	\$5,181	2,061
Net income per common share:		
Basic	\$0.23	0.09
Diluted	\$0.23	0.09
Weighted average number of shares of common stock outstanding:		
Basic	22,359,828	22,453,459
Diluted	22,366,749	22,461,094

See accompanying notes to unaudited interim consolidated financial statements.

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

	Three months ended	
	December 31, 2017	2016
Operating activities:		
Net income	\$5,181	2,061
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,415	7,121
Loss on disposal of property and equipment	48	—
Share-based compensation	160	217
Deferred income tax benefit	(4,446)	(170)
Non-cash interest expense	3	2
Changes in operating assets and liabilities		
Decrease (increase) in:		
Accounts receivable, net	383	1,128
Merchandise inventory	2,190	(1,657)
Prepaid expenses and other assets	22	1,395
Income tax receivable	351	—
(Decrease) increase in:		
Accounts payable	(3,564)	(286)
Accrued expenses	3,013	3,927
Deferred compensation	124	116
Deferred rent and leasehold incentives	89	240
Net cash provided by operating activities	10,969	14,094
Investing activities:		
Acquisition of property and equipment	(4,925)	(13,057)
Proceeds from sale of property and equipment	41	2,564
Net cash used in investing activities	(4,884)	(10,493)
Financing activities:		
Borrowings under credit facility	87,500	67,350
Repayments under credit facility	(91,300)	(67,701)
Capital and financing lease obligations payments	(132)	(113)
Repurchases of common stock	(581)	—

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Payments on withholding tax for restricted stock unit vesting	(4)	(12)
Net cash used in financing activities	(4,517)	(476)
Net increase in cash and cash equivalents	1,568	3,125
Cash and cash equivalents, beginning of period	6,521	4,017
Cash and cash equivalents, end of period	\$8,089	7,142
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$217	121
Cash paid for interest on capital and financing lease obligations, net of capitalized interest of \$25 and \$63, respectively	848	784
Income taxes paid	19	11
Supplemental disclosures of non-cash investing and financing activities:		
Acquisition of property and equipment not yet paid	\$1,722	7,243
Property acquired through capital and financing lease obligations	4,428	—

See accompanying notes to unaudited interim consolidated financial statements.

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NATURAL GROCERS BY VITAMIN COTTAGE, INC.

Notes to Unaudited Interim Consolidated Financial Statements

December 31, 2017 and 2016

1. Organization

Nature of Business

Natural Grocers by Vitamin Cottage, Inc. (Natural Grocers or the holding company) and its consolidated subsidiaries (collectively, the Company) operate retail stores that specialize in natural and organic groceries and dietary supplements. The Company operates its retail stores under its trademark *Natural Grocers by Vitamin Cottage*®. As of *December 31, 2017*, the Company operated *142* stores in *19* states. The Company also has a bulk food repackaging facility and distribution center in Golden, Colorado. The Company had *140* stores in *19* states as of *September 30, 2017*.

2. Basis of Presentation and Summary of Significant Accounting Policies

Consolidated Financial Statements

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

30.

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

The Company has *one* reporting segment: natural and organic retail stores. Sales from the Company's natural and organic retail stores are derived from sales of the following product categories, which are presented as a percentage of sales for the *three* months ended *December 31, 2017* and *2016*, as follows:

	Three months ended	
	December 31,	
	2017	2016
Grocery	67 %	66
Dietary supplements	22	22
Other	11	12
	100%	100

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities (including the fair value of assets acquired and liabilities assumed in a business combination), the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management reviews its estimates on an ongoing basis, including those related to allowances for self-insurance reserves, valuation of inventories, useful lives of property and equipment for depreciation and amortization, impairment of finite-lived intangible, long-lived assets, and goodwill, lease assumptions, valuation allowances for deferred tax assets and litigation based on currently available information. Changes in facts and circumstances *may* result in revised estimates and actual results could differ from those estimates.

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U.S Tax Reform

On *December 22, 2017*, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the Tax Reform Act). The Tax Reform Act significantly revises the future ongoing federal income tax by, among other things, lowering U.S. corporate income tax rates effective *January 1, 2018*. The Company has calculated a blended U.S. federal income tax rate of approximately *24.3%* for our fiscal year ending *September 30, 2018* and *21.0%* for subsequent fiscal years. For the *three* months ended *December 31, 2017*, these impacts resulted in a net non-cash tax benefit of approximately *\$4.3* million due to the favorable impact of the lower blended federal income tax rate and the remeasurement of our deferred tax balances.

The changes included in the Tax Reform Act are broad and complex. The final transition impacts of the Tax Reform Act *may* differ from the above estimate, due to, among other things, changes in interpretations of the Tax Reform Act, any legislative action to address questions that arise because of the Tax Reform Act and any changes in accounting standards for income taxes or related interpretations in response to the Tax Reform Act. The SEC has issued Staff Accounting Bulletin *118* (SAB *118*), which expresses the SEC's views regarding the application of Accounting Standards Codification *740*, "Income Taxes," (ASC *740*) in the reporting period that includes *December 22, 2017* (the date the Tax Reform Act was signed into law). SAB *118* allows for a measurement period of up to *one* year after the enactment date of the Tax Reform Act to finalize the recording of the related tax impacts. The Company currently anticipates finalizing and recording any resulting adjustments by the end of the fiscal year ending *September 30, 2018*.

Recently Adopted Accounting Pronouncements

In *July 2015*, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) *2015-11*, "Simplifying the Measurement of Inventory," Topic *330*, "Inventory" (ASU *2015-11*). The amendments in ASU *2015-11*, which apply to inventory that is measured using any method other than the last-in, *first*-out (LIFO) or retail inventory method, require that entities measure inventory at the lower of cost and net realizable value. The amendments in ASU *2015-11* should be applied on a prospective basis. ASU *2015-11* is effective for fiscal years beginning after *December 15, 2016* and interim periods within those years. The Company adopted the amendments of ASU *2015-11* effective *October 1, 2017*. The adoption of this standard did *not* have a material impact on its consolidated financial statements.

In *March 2016*, the FASB issued ASU *2016-09*, "Improvements to Employee Share-Based Payment Accounting," Topic *718*, "Compensation-Stock Compensation" (ASU *2016-09*). ASU *2016-09* includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the Company's financial statements, including income tax consequences, forfeitures and classification on the statement of cash flows. Under previous guidance, excess tax benefits and deficiencies from share-based compensation arrangements were recorded in equity when the awards vested or were settled. ASU *2016-09* requires prospective recognition of excess tax benefits and deficiencies in income tax expense, rather than paid-in-capital. The adoption of the standard did *not* have a

material impact on the Company's consolidated statements of income for the *three* months ended *December 31, 2017*.

In addition, under ASU 2016-09, excess tax income tax benefits from share-based compensation arrangements are classified as cash flow from operations, rather than as cash flow from financing activities. For the *three* months ended *December 31, 2017*, there were *no* excess income tax benefits.

The Company has elected to continue to estimate the number of share-based awards expected to vest, as permitted by ASU 2016-09, rather than electing to account for forfeitures as they occur.

ASU 2016-09 requires excess tax benefits and deficiencies to be prospectively excluded from assumed future proceeds in the calculation of diluted shares, resulting in a decrease in diluted weighted average shares outstanding of 2,879 shares for the *three* months ended *December 31, 2017*.

Recent Accounting Pronouncements

In *January 2017*, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment," Topic 350, "Intangibles – Goodwill and Other" (ASU 2017-04). The amendments in ASU 2017-04 simplify the accounting for goodwill impairment for all entities by requiring impairment charges to be based on the *first* step in the current *two*-step impairment test. An impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value should be recognized; however, the loss recognized should *not* exceed the total amount of goodwill allocated to that reporting unit. The amendments should be applied on a prospective basis. Early adoption is permitted for annual and interim goodwill impairment testing dates after *January 1, 2017* and is effective for the Company's *first* quarter of the fiscal year ending *September 30, 2020*. The Company is currently evaluating the impact that the adoption of these provisions will have on its consolidated financial statements.

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In *February 2016*, the FASB issued ASU 2016-02, “Leases,” Topic 842, “Leases” (ASU 2016-02). ASU No. 2016-02 requires lessees to recognize a right-of-use asset and corresponding lease liability for all leases with terms of more than 12 months. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. ASU 2016-02 also requires certain quantitative and qualitative disclosures. The provisions of ASU 2016-02 should be applied on a modified retrospective basis and are effective for the Company’s *first* quarter of the fiscal year ending *September 30, 2020*, with early adoption permitted. However, during *December 2017*, the FASB proposed amending ASU 2016-02 such that restatement of fiscal years 2018 and 2019 would *not* be required upon adoption. The adoption of ASU 2016-02 will result in a material increase to the Company’s consolidated balance sheets for lease liabilities and right-of-use assets. The Company is also performing a comprehensive review of its current processes to determine and implement changes required to support the adoption of this standard. As part of this review process, the Company is implementing new software solutions to support the lease reporting upon adoption. The Company is currently evaluating the other effects the adoption of ASU 2016-02 will have on its consolidated financial statements.

In *May 2014*, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers,” Topic 606, “Revenue from Contracts with Customers” (ASU 2014-09). ASU 2014-09 provides guidance for revenue recognition and will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled for the transfer of those goods or services. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. In *July 2015*, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers – Deferral of the Effective Date.” The FASB approved the deferral of ASU 2014-09, by extending the new revenue recognition standard’s mandatory effective date by *one* year and permitting public companies to apply the new revenue standard to annual reporting periods beginning after *December 15, 2017*. However, earlier adoption is permitted only for annual reporting periods beginning after *December 15, 2016*. The guidance in ASU 2014-09 will be effective for the Company in the *first* quarter of the fiscal year ending *September 30, 2019*. Further to ASU 2014-09 and ASU 2015-14, the FASB issued ASU No. 2016-08, “Revenue from Contracts with Customers,” Topic 606, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” (“ASU 2016-08”) in *March 2016* and ASU No. 2016-12, “Revenue from Contracts with Customers,” Topic 606, “Narrow-Scope Improvements and Practical Expedients” (“ASU 2016-12”) in *May 2016*. The amendments in ASU 2016-08 clarify the implementation guidance on principal versus agent considerations, including indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. ASU 2016-12 addresses narrow-scope improvements to the guidance on collectability, non-cash consideration, and completed contracts at transition. Additionally, the amendments in this ASU provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. The effective date and transition requirements for ASU 2016-08 and ASU 2016-12 are the same as ASU 2014-09. The Company is currently in the process of evaluating the impact of the adoption of ASU 2014-09, ASU 2016-08 and ASU 2016-12 on its consolidated financial statements. The Company currently does *not* plan to early adopt ASU 2014-09, ASU 2016-08 or ASU 2016-12.

3. Earnings Per Share

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

Presented below are basic and diluted EPS for the *three* months ended *December 31, 2017* and *2016*, dollars in thousands, except per share data:

	Three months ended December 31,	
	2017	2016
Net income	\$5,181	2,061
Weighted average number of shares of common stock outstanding	22,359,828	22,453,459
Effect of dilutive securities	6,921	7,635
Weighted average number of shares of common stock outstanding including effect of dilutive securities	22,366,749	22,461,094
Basic earnings per share	\$0.23	0.09
Diluted earnings per share	\$0.23	0.09

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There were 157,879 and 71,257 non-vested RSUs for the *three* months ended *December 31, 2017* and *2016*, respectively, excluded from the calculation of diluted EPS as they are antidilutive.

The Company did *not* declare any dividends in the *three* months ended *December 31, 2017* or *2016*.

4. Debt

Credit Facility

On *January 28, 2016*, the Company entered into a credit facility (the Credit Facility). The operating company is the borrower under the Credit Facility and its obligations under the Credit Facility are guaranteed by the holding company and VC2. The Credit Facility is secured by a lien on substantially all of the Company's assets. The amount available for borrowing under the Credit Facility is \$50.0 million, including a \$5.0 million sublimit for standby letters of credit. The Company has the right to borrow, prepay and re-borrow amounts under the Credit Facility at any time prior to the maturity date. The Credit Facility matures on *January 31, 2021*. For floating rate borrowings under the Credit Facility, interest is determined by the lender's administrative agent based on the most recent compliance certificate of the operating company and stated at the base rate less the lender spread based upon certain financial measures. For fixed rate borrowings under the Credit Facility, interest is determined by quoted LIBOR rates for the interest period plus the lender spread based upon certain financial measures. The unused commitment fee is based upon certain financial measures.

The Credit Facility requires compliance with certain customary operational and financial covenants, including a leverage ratio. The Credit Facility also contains certain other customary limitations on the Company's ability to incur additional debt, guarantee other obligations, grant liens on assets and make investments or acquisitions, among other limitations. Additionally, the Credit Facility prohibits the payment of cash dividends to the holding company from 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 incurred in the ordinary course of business, including cash dividends to the holding company for the repurchase of shares of common stock in an amount *not* to exceed \$10.0 million.

The Company had \$24.6 million and \$28.4 million outstanding under the Credit Facility as of *December 31, 2017* and *September 30, 2017*, respectively. As of each of *December 31, 2017* and *September 30, 2017*, the Company had undrawn, issued and outstanding letters of credit of \$1.0 million, which were reserved against the amount available for borrowing under the terms of the Credit Facility. The Company had \$24.4 million and \$20.6 million available for

borrowing under the Credit Facility as of *December 31, 2017* and *September 30, 2017*, respectively.

As of *December 31, 2017* and *September 30, 2017*, the Company was in compliance with the financial covenants under the Credit Facility.

Capital and Financing Lease Obligations

The Company had *18* and *17* leases as of *December 31, 2017* and *September 30, 2017*, respectively, that are included in capital and financing lease obligations (see Note 6). *No* rent expense is recorded for these capitalized real estate leases, but rather rental payments under the capital leases are recognized as a reduction of the capital and financing lease obligation and as interest expense. The interest rate on capital and financing lease obligations is determined at the inception of the lease.

Interest

The Company incurred gross interest expense of approximately *\$1.1* million for each of the *three* months ended *December 31, 2017* and *2016*. Interest expense for the *three* months ended *December 31, 2017* and *2016* relates primarily to interest on capital and financing lease obligations. The Company capitalized interest of less than *\$0.1* million and approximately *\$0.1* million for the *three* months ended *December 31, 2017* and *2016*, respectively.

5. Shareholders' Equity

Share Repurchases

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

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Prior to *October 1, 2017*, the Company repurchased 97,970 shares under the share repurchase program. During the *three months ended December 31, 2017*, the Company repurchased 101,573 shares under the share repurchase program. The Company did *not* repurchase any shares during the *three months ended December 31, 2016*.

Prior to *October 1, 2017*, the Company reissued 35,747 treasury shares at a cost of \$0.4 million to satisfy the issuance of common stock pursuant to the vesting of certain restricted stock unit awards and the award of stock grants. During the *three months ended December 31, 2017* and *2016*, the Company reissued 1,226 treasury shares at a cost of less than \$0.1 million and 1,867 treasury shares at a cost of less than \$0.1 million, respectively, to satisfy the issuance of common stock pursuant to the vesting of certain restricted stock unit awards and the award of common stock grants. At *December 31, 2017* and *September 30, 2017*, the Company held in treasury 162,570 shares and 62,223 shares, respectively, totaling approximately \$1.2 million and \$0.7 million, respectively.

Between *January 1, 2018* and *January 29, 2018* (the latest practicable date for making the determination), the Company has *not* repurchased any additional shares of the Company's common stock.

6. Lease Commitments

Capital and financing lease obligations as of *December 31, 2017* and *September 30, 2017*, were as follows, dollars in thousands:

	As of	
	December	September
	31,	30,
	2017	2017
Capital lease finance obligations, due in monthly installments through fiscal year 2033	\$28,981	26,930
Capital lease obligations, due in monthly installments through fiscal year 2041	4,943	4,999
Capital lease finance obligations for assets under construction, due in monthly installments through fiscal year 2033	3,800	1,499
Total capital and financing lease obligations	37,724	33,428
Less current portion	(604)	(548)
Total capital and financing lease obligations, net of current portion	\$37,120	32,880

7. Property and Equipment

The Company had the following property and equipment balances as of *December 31, 2017* and *September 30, 2017*, dollars in thousands:

	Useful lives	As of December 31, 2017	September 30, 2017
	(in years)		
Construction in process	<i>n/a</i>	\$7,373	5,286
Capitalized real estate leases for build-to-suit stores, including unamortized land of \$617 and \$617, respectively	<i>40</i>	<i>31,926</i>	<i>29,548</i>
Capitalized real estate leases	<i>15- 25</i>	<i>5,735</i>	<i>5,735</i>
Land	<i>n/a</i>	<i>192</i>	<i>192</i>
Buildings	<i>40</i>	<i>19,259</i>	<i>19,259</i>
Land improvements	<i>5 - 24</i>	<i>1,160</i>	<i>1,159</i>
Leasehold and building improvements	<i>1 - 25</i>	<i>132,647</i>	<i>131,679</i>
Fixtures and equipment	<i>5 - 7</i>	<i>117,834</i>	<i>115,888</i>
Computer hardware and software	<i>3 - 5</i>	<i>19,504</i>	<i>19,108</i>
		<i>335,630</i>	<i>327,854</i>
Less accumulated depreciation and amortization		<i>(150,441)</i>	<i>(143,437)</i>
Property and equipment, net		<i>\$185,189</i>	<i>184,417</i>

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

Depreciation and amortization expense for the *three* months ended *December 31, 2017* and *2016* is summarized as follows, dollars in thousands:

	Three months ended December 31, 2017	2016
Depreciation and amortization expense included in cost of goods sold and occupancy costs	\$ 196	248
Depreciation and amortization expense included in store expenses	6,850	6,519
Depreciation and amortization expense included in administrative expenses	369	354
Total depreciation and amortization expense	\$ 7,415	7,121

8. Accrued Expenses

The composition of accrued expenses as of *December 31, 2017* and *September 30, 2017* is summarized as follows, dollars in thousands:

	As of December 31, 2017	September 30, 2017
Payroll and employee-related expenses	\$ 7,849	5,391
Accrued property, sales and use tax payable	6,440	6,399

Accrued marketing expenses	454	648
Deferred revenue related to gift card sales	1,558	906
Other	876	820
Total accrued expenses	\$17,177	14,164

9. Income Taxes

Income taxes are accounted for in accordance with the provisions of ASC 740. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are remeasured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized. The Company remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in fiscal year 2018 at the blended federal rate of approximately 24.3%; those expected to reverse in future years, are remeasured at the new federal statutory rate of 21.0%.

Additionally, in calculating our annual effective tax rate, the Company has used assumptions and estimates that *may* change as a result of future guidance, interpretation, and rule-making from the Internal Revenue Service, the SEC, and the FASB and/or various other taxing jurisdictions. For example, the Company anticipates that state jurisdictions will continue to determine and announce their conformity to the Tax Reform Act, which could have an impact on its annual effective tax rate.

The remeasurement of the Company's deferred tax balance resulted in a non-cash tax benefit of approximately \$4.3 million for the *three* months ended *December 31, 2017*.

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10. Related Party Transactions

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

Chalet Properties, LLC: The Company has *five* operating leases and *one* capital lease with Chalet Properties, LLC (Chalet). Chalet is owned by the Company's *four* non-independent Board members, Kemper Isely, Zephyr Isely, Heather Isely and Elizabeth Isely, and other related family members. Rent paid to Chalet was approximately *\$0.3* million for each of the *three* months ended *December 31, 2017* and *2016*.

Isely Family Land Trust LLC: The Company has *one* operating lease with the Isely Family Land Trust LLC (the Land Trust). The Land Trust is owned by the Isely Children's Trust and by the Margaret A. Isely Family Trust. Rent paid to the Land Trust was less than *\$0.1* million for each of the *three* months ended *December 31, 2017* and *2016*.

FTVC LLC: The Company has *one* operating lease for a store location with FTVC LLC, which is owned by the Company's *four* non-independent Board members and other related family members. Rent paid to FTVC LLC was less than *\$0.1* million for each of the *three* months ended *December 31, 2017* and *2016*.

11. Commitments and Contingencies

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

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

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

Company Overview

We operate natural and organic grocery and dietary supplement stores that are focused on providing high quality products at affordable prices, exceptional customer service, nutrition education and community outreach. We offer a variety of natural and organic groceries and dietary supplements that meet our strict quality standards. We believe we have been at the forefront of the natural and organic foods movement since our founding. We are headquartered in Lakewood, Colorado. As of December 31, 2017, we operated 142 stores in 19 states, including Colorado, Arkansas, Arizona, Idaho, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, Texas, Utah, Washington and Wyoming. We also operate a bulk food repackaging facility and distribution center in Golden, Colorado.

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. During the twelve months ended December 31, 2017, our new stores averaged approximately 11,000 selling square feet. Our new prototype store has approximately 10,000 square feet of selling space. We anticipate that in the future, a majority of our new stores will use the new prototype layout.

The growth in the organic and natural foods industry and growing consumer interest in health and nutrition have enabled us to continue to open new stores and enter new markets. During the five fiscal years ended September 30, 2017, we increased our store count at a compound annual growth rate of 18.9%. In fiscal year 2017, we opened 14 new stores, and we currently plan to open eight to 10 new stores in fiscal year 2018, two of which opened during the three months ended December 31, 2017. Since December 31, 2017, we have opened one new store in Texas. As of the date of this report, we have signed leases for 10 new stores that we plan to open in fiscal years 2018 and beyond. During fiscal year 2018, we plan to relocate three to four stores. During the quarter ended December 31, 2017, we relocated one store.

Performance Highlights

Key highlights of our performance for the three months ended December 31, 2017 are discussed briefly below and in further detail throughout this MD&A. Key financial metrics, including, but not limited to, comparable store sales, daily average comparable store sales, mature store sales and daily average mature store sales are defined under the caption “Key Financial Metrics in Our Business,” presented later in this MD&A.

Net sales. Net sales were \$202.5 million for the three months ended December 31, 2017, an increase of \$18.9 million, or 10.3%, compared to net sales of \$183.6 million for the three months ended December 31, 2016.

Comparable store sales and daily average comparable store sales. Comparable store sales and daily average comparable store sales for the three months ended December 31, 2017 each increased 4.7% compared to the three months ended December 31, 2016.

Mature store sales and daily average mature store sales. Mature store sales and daily average mature store sales for the three months ended December 31, 2017 each increased 1.6% compared to the three months ended December 31, 2016.

Net income. Net income was \$5.2 million for the three months ended December 31, 2017, an increase of \$3.1 million, or 151.4% compared to net income of \$2.1 million for the three months ended December 31, 2016. Net income was favorably impacted by \$4.3 million due to the non-cash remeasurement of deferred tax assets and liabilities.

EBITDA. Earnings before interest, taxes, depreciation and amortization (EBITDA) was \$9.6 million for the three months ended December 31, 2017, a decrease of \$1.7 million, or 14.9%, from \$11.3 million for the three months ended December 31, 2016. EBITDA is not a measure of financial performance under GAAP. Refer to the “Non-GAAP Financial Measures” section in this MD&A for a definition of EBITDA and a reconciliation of net income to EBITDA.

Liquidity. As of December 31, 2017, cash and cash equivalents was \$8.1 million, and there was \$24.4 million available for borrowing under our \$50.0 million Credit Facility, net of undrawn, issued and outstanding letters of credit of \$1.0 million.

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New store growth. We opened two new stores during the three months ended December 31, 2017. We operated a total of 142 stores as of December 31, 2017. We plan to open a total of eight to 10 new stores in fiscal year 2018, which would result in an annual new store growth rate of 5.7% to 7.1% for fiscal year 2018.

Store Relocations and Remodels. During fiscal year 2018, we plan to relocate three to four stores. During the quarter ended December 31, 2017, we relocated one store.

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, the level of disposable consumer income, consumer debt, interest rates, the price of commodities, the political environment and consumer confidence. In this regard, we believe our financial results for the three months ended December 31, 2017 reflected improvement in the oil and gas markets we serve, although they generally continue to lag behind our non-oil and gas markets.

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

As we expand across the United States and enter markets where consumers may not be as familiar with our brand, we seek to secure prime real estate locations for our stores to establish greater visibility with consumers in those markets. This strategy has resulted in higher lease costs, and we anticipate these increased costs will continue for the foreseeable future. Our financial results for the three months ended December 31, 2017 reflect the effects of these factors, and we anticipate future periods will be similarly impacted.

Our performance is also impacted by trends regarding natural and organic products, dietary supplements and at-home meal preparation. Consumer preferences towards dietary supplements or natural and organic food products might shift as a result of, among other things, economic conditions, food safety perceptions, changing consumer choices and the cost of these products. A change in consumer preferences away from our offerings, including those resulting from

reductions or changes in our offerings, would have a material adverse effect on our business. Additionally, negative publicity regarding the safety of dietary supplements, product recalls or new or upgraded regulatory standards may adversely affect demand for the products we sell and could result in lower consumer traffic, sales and results of operations.

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

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Outlook

We believe there are several key factors that have contributed to our success and will enable us to increase our comparable store sales and continue to expand profitably. These factors include a loyal customer base, increasing transaction count and/or 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. The rate of new store growth in the foreseeable future is expected to moderate somewhat compared to recent years, depending on economic and business conditions and other factors. During the past few years, we have expanded our infrastructure to enable us to support our continued unit growth. This has included implementing our enterprise resource planning system, hiring key personnel, developing efficient new store opening construction and operations processes and relocating and expanding our bulk food repackaging facility and distribution center. In addition, we have taken a number of actions in recent years which we believe have enhanced customer loyalty and increased customer engagement, including redesigning our website (www.naturalgrocers.com), enhancing digital and social media presence, and introducing the *{N}power*[®] customer appreciation program at all of our stores.

We believe there are opportunities for us to continue to expand our store base, expand profitability and increase comparable store sales. However, future sales growth, including comparable store sales, and our profitability could vary due to increasing competitive conditions in the natural and organic grocery and dietary supplement industry and regional and general economic conditions. As we continue to expand our store base, we believe there are opportunities for increased leverage in costs, such as administrative expenses, as well as increased economies of scale in sourcing products. However, due to our commitment to providing high-quality products at affordable prices and increased competition, such sourcing economies and efficiencies at our bulk food repacking facility and distribution center may not be reflected in our gross margin in the near term. In addition, our ability to leverage costs may be limited due to the fixed nature of our rent obligations and related occupancy expenses.

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

Key Financial Metrics in Our Business

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

Net sales

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

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

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

Change in mature store sales. We begin to include sales from a store in mature store sales after the store has been open for any part of five fiscal years (for example, our mature stores for fiscal year 2018 are stores that opened during or before fiscal year 2013). 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 (for example, as a result of leap years or the Easter holiday shift between quarters).

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

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

Cost of goods sold and occupancy costs

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

Gross profit and gross margin

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

Store expenses

Store expenses consist of store level expenses, such as salary and benefits, share-based compensation, supplies, utilities, depreciation, advertising, bank credit card charges and other related costs associated with 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 consist of labor-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 being a public company, 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 consists of gross profit less store expenses, administrative expenses and pre-opening and relocation expenses. Operating income can be impacted by a number of factors, including the timing of new store openings and store relocations, whether or not a store lease is classified as an operating, capital or financing lease, as well as fluctuations in store expenses and administrative expenses. The amount of time it takes for new stores to become profitable can vary depending on a number of factors, including location, competition, a new market versus an existing market and the strength of store management.

Interest expense

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

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:

	Three months ended December 31, 2017 2016	
Statements of Income Data:*		
Net sales	100.0%	100.0
Cost of goods sold and occupancy costs	73.7	71.6
Gross profit	26.3	28.4
Store expenses	22.3	22.8
Administrative expenses	2.6	2.7
Pre-opening and relocation expenses	0.3	0.7
Operating income	1.1	2.3
Interest expense	(0.5)	(0.5)
Income before income taxes	0.5	1.7
Benefit from (provision for) income taxes	2.0	(0.6)
Net income	2.6 %	1.1

**Figures may not sum due to rounding.*

Number of stores at end of period	142	131
Number of stores opened during the period	2	5
Total store unit count increase period over period	8.4	% 22.4
Change in comparable store sales	4.7	(0.6)
Change in daily average comparable store sales	4.7	(0.6)
Change in mature store sales	1.6	(2.3)
Change in daily average mature store sales	1.6	(2.3)

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

	Three months ended		Change In		
	December 31, 2017	2016	Dollars	Percent	
Statements of Income Data:					
Net sales	\$202,480	183,577	18,903	10.3	%
Cost of goods sold and occupancy costs	149,321	131,424	17,897	13.6	
Gross profit	53,159	52,153	1,006	1.9	
Store expenses	45,166	41,843	3,323	7.9	
Administrative expenses	5,257	4,883	374	7.6	
Pre-opening and relocation expenses	543	1,261	(718)	(56.9)	
Operating income	2,193	4,166	(1,973)	(47.4)	
Interest expense	(1,089)	(983)	(106)	10.8	
Income before income taxes	1,104	3,183	(2,079)	(65.3)	
Benefit from (provision for) income taxes	4,077	(1,122)	5,199	(463.4)	
Net income	\$5,181	2,061	3,120	151.4	

Net sales

Net sales increased \$18.9 million, or 10.3%, to \$202.5 million for the three months ended December 31, 2017 compared to \$183.6 million for the three months ended December 31, 2016, due to a \$10.3 million increase in sales from new stores and a \$8.6 million increase in comparable store sales. Daily average comparable store sales increased 4.7% for the three months ended December 31, 2017 compared to the three months ended December 31, 2016. The daily average comparable store sales increase resulted from a 4.8% increase in daily average transaction count offset by a 0.1% decrease in average transaction size. Comparable store average transaction size was \$35.54 for the three months ended December 31, 2017. Daily average mature store sales increased 1.6% for the three months ended December 31, 2017 compared to the three months ended December 31, 2016. The increase in comparable store sales during the three months ended December 31, 2017 was primarily driven by several marketing initiatives and promotional pricing campaigns. In addition, we believe the increase in comparable store sales during the three months ended December 31, 2017 reflected enhanced focus on leadership, training, and improved operating processes in our stores.

Gross profit

Gross profit increased \$1.0 million, or 1.9%, to \$53.2 million for the three months ended December 31, 2017 compared to \$52.2 million for the three months ended December 31, 2016, primarily driven by an increase in the number of comparable stores. Gross margin decreased to 26.3% for the three months ended December 31, 2017 from 28.4% for the three months ended December 31, 2016. Product margin as a percentage of sales during the three months ended December 31, 2017 decreased due to our promotional pricing campaigns and a shift in sales mix to lower margin products. Additionally, gross margin during the three months ended December 31, 2017 was negatively impacted by an increase in occupancy costs as a percentage of sales, primarily due to the higher average lease expenses experienced at newer format stores opened since fiscal year 2013 and at relocated stores.

We had 18 and 16 store leases that were classified as capital and financing lease obligations for the three months ended December 31, 2017 and 2016, respectively. If these leases had qualified as operating leases, the straight-line rent expense would have been included in occupancy costs, and our costs of goods sold and occupancy costs as a percentage of sales during the three months ended December 31, 2017 and 2016, would have been approximately 55 basis points higher for each period.

Store expenses

Store expenses increased \$3.3 million, or 7.9%, to \$45.2 million for the three months ended December 31, 2017 compared to \$41.8 million for the three months ended December 31, 2016. Store expenses as a percentage of sales were 22.3% and 22.8% for the three months ended December 31, 2017 and 2016, respectively. The decrease in store expenses as a percentage of sales was primarily due to decreases in labor-related expenses, marketing and depreciation, offset by an increase in utilities.

Administrative expenses

Administrative expenses increased \$0.4 million, or 7.6%, to \$5.3 million for the three months ended December 31, 2017 compared to \$4.9 million for the three months ended December 31, 2016. The increase in administrative expenses was due primarily to increased compensation expenses. Administrative expenses as a percentage of sales were 2.6% and 2.7% for the three months ended December 31, 2017 and 2016, respectively.

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Pre-opening and relocation expenses

Pre-opening and relocation expenses decreased \$0.7 million, or 56.9%, for the three months ended December 31, 2017 to \$0.5 million compared to \$1.3 million for the three months ended December 31, 2016, due to the impact of the number and timing of new store openings and relocations. We opened two new stores and relocated one store during the three months ended December 31, 2017 and opened five new stores and relocated no stores during the three months ended December 31, 2016.

Interest expense

Interest expense, net of capitalized interest, increased \$0.1 million, or 10.8%, for the three months ended December 31, 2017 compared to the three months ended December 31, 2016. The increase in interest expense is primarily due to higher average borrowings under our Credit Facility and an increase in the number of capital leases during the three months ended December 31, 2017. 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 40 basis points lower than as reported for the three months ended December 31, 2017 and 2016, respectively.

Income taxes

Income taxes decreased \$5.2 million for the three months ended December 31, 2017 to a \$4.1 million benefit compared to \$1.1 million expense for the three months ended December 31, 2016. Exclusive of the adjustment to deferred income tax assets and liabilities, the Company's effective income tax rate for the three months ended December 31, 2017 was approximately 23.5% as compared to 35.2% for the three months ended December 31, 2016. The decrease in the effective income tax rate for the three months ended December 31, 2017 is a result of the recent tax reform.

Net income

Net income was \$5.2 million, or \$0.23 diluted earnings per share, for the three months ended December 31, 2017 compared to \$2.1 million, or \$0.09 diluted earnings per share, for the three months ended December 31, 2016. Excluding the favorable impact of the remeasurement of our deferred tax assets and liabilities as a result of the enactment of the Tax Reform Act, net income was \$0.8 million or \$0.04 diluted earnings per share for the three months ended December 31, 2017 compared to \$2.1 million, or \$0.09 diluted earnings per share, for the three months ended December 31, 2016.

*Non-GAAP financial measures**EBITDA*

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

	Three months ended December 31,	
	2017	2016
Net income	\$5,181	2,061
Interest expense	1,089	983
Benefit from (provision for) income taxes	(4,077)	1,122
Depreciation and amortization	7,415	7,121
EBITDA	\$9,608	11,287

EBITDA decreased 14.9% to \$9.6 million in the three months ended December 31, 2017 compared to \$11.3 million for the three months ended December 31, 2016. EBITDA as a percentage of sales was 4.7% and 6.1% in the three months ended December 31, 2017 and 2016, respectively. Stores with leases that are classified as capital and financing lease obligations, rather than being reflected as operating leases, increased EBITDA as a percentage of sales by approximately 55 basis points for each of the three months ended December 31, 2017 and 2016, due to the impact on cost of goods sold and occupancy costs as discussed above, as well as occupancy costs that would have been included in pre-opening expenses prior to the stores' opening dates if these leases had been accounted for as operating leases.

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

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

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

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

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

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

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

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

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

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

Liquidity and Capital Resources

Our ongoing primary sources of liquidity are cash generated from operations, current balances of cash and cash equivalents and borrowings under the Credit Facility. Our primary uses of cash are for purchases of inventory, operating expenses, capital expenditures predominantly in connection with opening, relocating and remodeling stores, interest and principal payments for outstanding indebtedness and corporate taxes. As of December 31, 2017, we had \$8.1 million in cash and cash equivalents, as well as \$24.4 million available for borrowing under our Credit Facility.

On May 5, 2016, our Board authorized a two-year share repurchase program pursuant to which the Company may expend up to \$10.0 million to repurchase shares of the Company's common stock. During the three months ended December 31, 2017, we repurchased 101,573 shares of our common stock under the share repurchase program. We expect funding for any future share repurchases will come from operating cash flow, excess cash and/or borrowings under our Credit Facility. The timing and the amount of shares repurchased will be dictated by our capital needs and stock market conditions.

We plan to continue to open new stores, which may require us to borrow additional amounts under the Credit Facility. We plan to spend approximately \$20 million to \$25 million on capital expenditures during the remainder of fiscal year 2018 in connection with six to eight additional new store openings and two to three additional store relocations. We believe that cash and cash equivalents, together with the cash generated from operations and the borrowing availability under our Credit Facility will be sufficient to meet our working capital needs and planned capital expenditures, including capital expenditures related to new store needs for at least the next twelve months. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within days from the related sale.

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We anticipate that our new stores will require, on average, an upfront capital investment of approximately \$2.2 million per store consisting of capital expenditures of approximately \$1.6 million, net of tenant allowances, initial inventory of approximately \$0.3 million, net of payables, and pre-opening expenses of approximately \$0.3 million.

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

	Three months ended	
	December 31,	
	2017	2016
Net cash provided by operating activities	\$10,969	14,094
Net cash used in investing activities	(4,884)	(10,493)
Net cash used in financing activities	(4,517)	(476)
Net increase in cash and cash equivalents	1,568	3,125
Cash and cash equivalents, beginning of period	6,521	4,017
Cash and cash equivalents, end of period	\$8,089	7,142

Operating Activities

Net cash provided by operating activities consists primarily of net income adjusted for non-cash items, including depreciation and amortization and changes in deferred taxes, and the effect of working capital changes. Cash provided by operating activities decreased \$3.1 million, or 22.2%, to \$11.0 million for the three months ended December 31, 2017 compared to \$14.1 million for the three months ended December 31, 2016. The decrease in cash provided by operating activities was primarily due to a decrease in accounts payable, partially offset by a decrease in inventory, as adjusted for non-cash items such as depreciation and amortization resulting from the addition of new stores. Our working capital requirements for inventory will likely increase as we continue to open new stores.

Investing Activities

Net cash used in investing activities decreased \$5.6 million, or 53.4%, to \$4.9 million for the three months ended December 31, 2017 compared to \$10.5 million for the three months ended December 31, 2016. This decrease was due to an \$8.1 million decrease in cash paid for property and equipment, which was driven by fewer new store openings, relocations and remodels in the quarter ended December 31, 2017. This decrease was partially offset by \$2.6 million proceeds, net of commissions, related to the sale/leaseback on one store building in the quarter ended December 31, 2016.

Financing Activities

Cash used in financing activities consists primarily of borrowings and repayments under our Credit Facility and payments of capital and financing lease obligations. Cash used in financing activities was \$4.5 million and \$0.5 million for the three months ended December 31, 2017 and 2016, respectively.

Credit Facility

The amount available for borrowing under the Credit Facility is \$50.0 million, including a \$5.0 million sublimit for standby letters of credit. The operating company is the borrower under the Credit Facility and its obligations under the Credit Facility are guaranteed by the holding company and VC2. The Credit Facility is secured by a lien on substantially all of the Company's assets. The Company has the right to borrow, prepay and re-borrow amounts under the Credit Facility at any time prior to the maturity date. The Credit Facility matures on January 31, 2021.

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

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

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We had \$24.6 million outstanding under the Credit Facility as of December 31, 2017 and \$28.4 million outstanding under the Credit Facility as of September 30, 2017. As of each of December 31, 2017 and September 30, 2017, we had undrawn, issued and outstanding letters of credit of \$1.0 million, which were reserved against the amount available for borrowing under the terms of the Credit Facility. We had \$24.4 million available for borrowing under the Credit Facility as of December 31, 2017 and \$20.6 million available for borrowing under the Credit Facility as of September 30, 2017.

As of December 31, 2017 and September 30, 2017, the Company was in compliance with the financial covenants under the Credit Facility.

Share Repurchases

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

Off-Balance Sheet Arrangements

As of December 31, 2017, our off-balance sheet arrangements consisted of operating leases and the undrawn portion of our Credit Facility. All of our stores and facilities, with one exception, are leased. We own buildings in which five of our stores are located; those buildings are located on land that is leased pursuant to a ground lease. As of December 31, 2017, 18 store leases were classified as capital and financing lease obligations, and the remaining leases were classified as operating leases in our consolidated financial statements. We have no other off-balance sheet arrangements that have had, or are reasonably likely to have, a material effect on our consolidated financial statements or financial condition.

Recent Accounting Pronouncements

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

Critical Accounting Policies

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

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Based on that evaluation, our principal executive officers and principal financial and accounting officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of December 31, 2017.

Changes in Internal Control over Financial Reporting

Management implemented additional internal controls over financial reporting to ensure compliance with the Tax Reform Act. There were no other changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

We periodically are involved in various legal proceedings, including discrimination and other employment-related claims, customer personal injury claims, investigations and other proceedings arising in the ordinary course of business. When the potential liability from a matter can be estimated and the loss is considered probable, we record the estimated loss. Due to uncertainties related to the resolution of lawsuits, investigations and claims, the ultimate outcome may differ from our estimates. 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 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part I, “Item 1A-Risk Factors,” of our Form 10-K.

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

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The following table presents information with respect to purchases of the Company's common stock during the three months ended December 31, 2017 by the Company or any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Exchange Act.

Period	Total Number of Shares Purchased	Average Price Paid Per Share⁽¹⁾	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs⁽²⁾	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
October 1, 2017 to October 31, 2017	87,950	\$5.69	185,920	\$8,410
November 1, 2017 to November 30, 2017	13,623	5.91	199,543	8,329
December 1, 2017 to December 31, 2017	—	—	199,543	8,329
Total	101,573	\$5.72	199,543	\$8,329

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

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

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Item 6. Exhibits

EXHIBIT INDEX

Exhibit

Number Description

10.46	<u>Employment offer letter to Todd Dissinger dated December 5, 2017</u>
10.47	<u>Notice of Grant of Stock Unit Award to Todd Dissinger dated January 2, 2018</u>
31.1	<u>Certification of Kemper Isely, a Principal Executive Officer Required Under Section 302(a) of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Zephyr Isely, a Principal Executive Officer Required Under Section 302(a) of the Sarbanes-Oxley Act of 2002</u>
31.3	<u>Certification of Todd Dissinger, Principal Financial Officer Required Under Section 302(a) of the Sarbanes-Oxley Act of 2002</u>
32.1†	<u>Certification of Principal Executive Officers and Principal Financial Officer Required Under 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101	The following materials from Natural Grocers by Vitamin Cottage, Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 31, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of December 31, 2017 (unaudited) and September 30, 2017, (ii) Consolidated Statements of Income for the three months ended December 31, 2017 and 2016 (unaudited), (iii) Consolidated Statements of Cash Flows for the three months ended December 31, 2017 and 2016 (unaudited) and (iv) Notes to Unaudited Interim Consolidated Financial Statements.

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized on February 1, 2018.

Natural Grocers by Vitamin Cottage, Inc.

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

By: /s/ TODD DISSINGER
Todd Dissinger, Chief Financial Officer
(Principal Financial and Accounting Officer)