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United Natural Foods, Inc. (UNFI)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the UNFI Fiscal 2022 First Quarter Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Steve Bloomquist, Vice President of Investor Relations. Please go ahead.

Steven J. Bloomquist

Vice President-Investor Relations, United Natural Foods, Inc.

Good morning, everyone. Thank you for joining us on UNFI's first quarter fiscal 2022 earnings conference call. By now, you should have received a copy of the earnings release issued this morning. The press release, webcast, and a supplemental slide deck are available under the Investors section of the company's website at www.unfi.com, under the Events tab.

Joining me for today's call are Sandy Douglas, our Chief Executive Officer; John Howard, our Chief Financial Officer; Chris Testa, President of UNFI; and Eric Dorne, our Chief Operating Officer. Sandy, Chris, and John will provide a business update, after which we'll take your questions.

Before we begin, I'd like to remind everyone that comments made by management during today's call may contain forward-looking statements. These forward-looking statements include plans, expectations, estimates, and projections that might involve significant risks and uncertainties. These risks are discussed in the company's earnings release and SEC filings. Actual results may differ materially from the results discussed in these forward-looking statements. And lastly, I'd like to point out that during today's call, management will refer to certain non-GAAP financial measures. Definitions and reconciliations to the most comparable GAAP financial measures are included in our press release.

I'll now turn the call over to Sandy.

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

Thanks Steve. Good morning, everyone, and thank you for joining us on our fiscal 2022 first quarter earnings call. As you saw in this morning's press release, we delivered first quarter results through a time of continued challenges across the industry, including ongoing supply chain difficulties, declining fill rates and rising inflation. UNFI is performing through this unpredictable environment by steadfastly focusing on what we need to do to make our customer successful, which will continue to be our core operating objective.

Tomorrow as I cross the four-month mark at UNFI, I continue to invest a significant amount of my time meeting with our customers, with the simple goal of learning as much as I can about their business. What differentiates their offering in the marketplace, what are their biggest opportunities and pain points and what can we do to add value to their operations. Making customers stronger is a core tenant of UNFI's mission statement and I have a genuine passion for helping food retailers succeed and I am committed to doing everything possible to bring solutions that accomplish this.

Our teams regularly meet with customers to introduce new items, to plan and coordinate promotions and to look forward to the next major selling event. Customers were encouraged to order early for this year's November, December holiday season and build their inventories wherever possible. We also make sure they know about the many services that UNFI offers to lower their cost structure, increase sales, and simplify their operations. We've received positive feedback from our customers on the work that we did together around Thanksgiving, and now we're laser focused on doing the best possible job to meet their needs as we move through the upcoming holidays.

Further, I've initiated conversations with several of our largest suppliers, many of whom I've known for quite some time. Having been on the supplier side of the industry for 30 years, I know how important it is to partner across the supply chain to transparently share information and identify opportunities to increase distribution and maximize sales.

UNFI's [ph] B2B2C (00:04:16) business model puts us in a unique position to help suppliers understand and access our diverse and vibrant retail customers and their 30,000 retail locations. To more effectively bringing together suppliers and customers, we're developing unique new programs that provide better and deeper insights into UNFI's diverse retailer base, so that UNFI, our suppliers and our customers can collectively work together in partnership to create more and more value together.

I've also enjoyed meeting many of our frontline sales and supply chain associates in sales meetings and in our distribution centers. This has given me the opportunity to hear firsthand what's on their minds. What issues are most important to them and how we can continue to increase engagement in meaningful ways. A common theme during these visits is how proud our associates are to be part of the important role that UNFI plays in keeping the

food supply chain flowing. I also touched upon UNFI's culture on our last call which I've now had more exposure to. We're proud of the work that we've done around ESG topics and our Better for All mission of making the world a better place not just for one, but for all. And it's core to who we are as a company.

From our top priority of associate safety to an ongoing commitment toward diversity and inclusion to ambitious climate and environmental goals to name just a few, UNFI's core value remains doing the right thing every day. We look forward to sharing our 2021 ESG report with all of you in early calendar 2022. Overall, we're encouraged with the first quarter and the start to fiscal 2022. Despite a difficult backdrop which isn't likely to change in the short-term, the momentum that I spoke about on the last call is continuing and we expect to carry forward the momentum for the balance of the fiscal year.

Our Fuel the Future strategy is customer-focused, growth-oriented and the blueprint for what will drive UNFI for the foreseeable future. Our energy is dedicated to every element of customer support to make sure we do the best job possible taking care of our customers in a complicated environment. Having said that, I also find it encouraging that our associates across the board are never satisfied, they are continually looking for how we can get better for our customers and our suppliers in the days, weeks and months ahead.

Let me now turn the call over to our President, Chris Testa, for his comments on our performance. Chris?

Christopher P. Testa

President, United Natural Foods, Inc.

Thanks Sandy, and good morning, everyone. On today's call I'll provide further color on key drivers behind UNFI's Q1 results and future growth, the trends that are impacting our industry and some insights on UNFI's operating environment.

Let's start with our results for the quarter where consolidated sales came in at \$7 billion, a 4.7% increase over last year's Q1 and nearly a 4% sequential increase from the fourth quarter. It's worth noting that this is only the second time in the company's history that revenue totaled \$7 billion in a single quarter. All three major sales channels experienced year-over-year growth which was driven by two primary factors, new business wins and inflation. Modest market contraction and continued supply chain challenges were also partial offsets to these favorable sales drivers.

Our strong Supernatural sales were driven by winning new categories and SKUs with our largest customer, which reflects the strength of our relationship and the value we bring to their business. Independent sales channel growth was driven largely by new sales we realized from our Allentown, Pennsylvania facility, which began serving independents in the New York Metro area in Q1. This new DC has been the largest distribution center startup in UNFI's history. And its run rate volume has quickly made it a top 15 warehouse in terms of revenue. As you'd anticipate, we've had some learnings along the way, but we are pleased with our progress and the greater opportunity to pursue enhance customer service to existing customers and new customer growth in the New York Metro market. Both in the Supernatural and independent new business wins had been exceeding volume expectations and we expect continued strong performance through the balance of this fiscal year. Our sales team also remains focused on cross-selling and we generated over \$60 million of incremental cross-selling revenue in the quarter.

The majority of an incremental cross-selling revenue occurred in our Chains channel where we have expanded the categories we sell to these large retailers by offering the benefits of consolidating their purchases with UNFI. This includes retailers who operate their own captive distribution networks. Our first quarter cross-selling gains kept us on track to deliver the \$1 billion cumulative cross-selling revenue target by the end of this fiscal year.

Across all channels our top 100 customers realized year-over-year revenue gains of 6.7% driven by expanding the categories we service with our existing customer base and new business initiatives. Our growth platforms that we previously outlined in our Fuel the Future strategy also expanded in Q1.

Our fresh sales team has been working closely with our existing customers to add meat, produce and bakery, deli items in the all-important perimeter of the store. In addition to the fresh categories, we're onboarding in Supernatural. We'll now be distributing produce to another large national customer as the result of our expansive DC footprint in category expertise, and every week we're gaining shelf space with fresh categories at a regional level.

Our own brands business continues to roll out new items and push for additional points of distribution with the 30,000 customer outlets UNFI currently services. Our brands portfolio of over 5,000 SKUs allows us to pivot quickly and tap into emerging consumer trends. Accordingly, our revenue from natural, organic brands increased over 6% in the quarter as consumers seek products which these clean label attributes. We've also seen traction with a new save everyday pricing program for our value items that are positioned to be attractive, affordable alternatives to national brands.

Finally, on the professional services side, we had a strong quarter from retailers seeking solutions to lower their operating cost or expand revenue beyond retail and groceries. We're seeing a 15% increase in the number of remodels being done by our customers compared to last year as they look to reinvest in their businesses. Our Coin Cloud offering which enables our customers to bring cryptocurrency to their shoppers continues to gain traction. We've now placed nearly 500 machines in customer stores and are scheduled for another 200 in the coming months.

Regarding inflation, we saw inflation impact our Wholesale net sales by 2.5% to 3% net of volume in exchanges. Due to the cost plus nature of the majority of our pricing agreements, inflation is typically a positive driver of top-line revenue and margin gains. For Q1, our growth can be looked at as roughly half coming from new business wins, net of expected market contraction, and half coming from inflation. At least for the next several months, we don't see inflation easing. Our procurement and merchandising teams are working closely with our suppliers to offset some of these price hikes with increased promotional activity to help our customers manage through this period.

Many of the underlying drivers of this inflation ranging from commodity shortages to labor shortages to limited transportation are also adversely impacting UNFI fill rates. After many months of steady improvement, we like the broader industry, have seen supplier inbound fill rates deteriorate, simply put, lower fill rates adversely impact our customers who may not receive everything they order and rely on UNFI to carry a broad assortment of SKUs that go beyond just the top sellers. At the same time, limited product availability typically reduces vendor new item launches and promotional spend as suppliers aren't likely to promote products where supply levels are scarce.

To do the best job we can for our customers, we continue to diligently work with our suppliers to find and source as much product as possible and to recommend alternative solutions, so our customers can present a complete offering on their shelves. These alternatives include actions like substituting own brands where national brand availability is low updating planograms to focus on items with higher anticipated in-stock positions and daily contact with suppliers in an effort to make sure UNFI receives its fair share of product and has the critical insight of what's to come, so we can plan accordingly.

For the most part, we were successful in helping our customers navigate through fill rate challenges during Thanksgiving. And we are now focused on the December holiday season. We believe we are well-positioned from an inventory perspective and have been planning with our customers secure holiday focus items well in advance.

Shifting to operations, I'm pleased to report that our Centralia facility that experienced a temporary voluntary shutdown in August due to late summer rise in COVID cases is fully operational. We incurred some higher operational cost during the recovery period as we did everything possible to leverage the scale of our network to continue to service impacted customers, including temporarily shifting volume to neighboring DCs. Broadly speaking, UNFI is non-immune to the challenges facing today's labor market, but we are actively managing our way through these difficult times with innovative employee programs designed to attract and retain frontline workers. We have made significant investments in wages and are focusing our recruiting efforts on attracting associates into our DCs.

Investments in programs like Flex Shift and early access which is a program that allows DC employees to receive pay earlier than traditional weekly paychecks are helping us attract and retain more employees. These efforts are paying off and have led to a 30% reduction in open head count in our warehouse operations compared to year-end. We're still not where we need to be, but these programs and others are designed to address worker concerns and lifestyle needs. They are also expected to contribute to long-lasting associate retainment and consistent performance for our customers.

Finally, we're encouraged by the performance of our retail stores as sales were down only slightly against a very strong comparison in fiscal 2021's first quarter, when sales increased by more than 15%.

On a two-year stack basis, retail sales increased 14.7%. Operationally, we introduced enhancements to our e-commerce and delivery platforms at Cub to better meet the needs of our customers. Online orders at Cub now allow customers to use their My Cub Rewards card to gain access to exclusive promotions and digital coupons and all orders are shopped locally by dedicated team of Cub associates. This is another great example of adapting our business model to the changing needs of today's consumer, so we can serve them in the best way possible.

Although we expect supply chain challenges to continue, we also believe that strong food at home trends and inflation will help offset some of these headwinds. Against that backdrop as Sandy said, our energy is focused on making share we are fully resourced towards customer support as we can be. While there are challenges, we're focused on implementing solutions to minimize supply chain disruptions and delivering for our customers. We also continue to build our pipeline with customers looking to consolidate purchases with UNFI or potential new customers looking to leverage our scale to provide consistent service in these volatile times.

Our new customer pipeline is more robust than any time in my 12 years here at UNFI, and we're optimistic about our prospects. We are pleased with our performance this quarter and optimistic about the balance of fiscal 2022. The environment has been challenging and will likely remain that way at least in the near-term, but we are confident in our ability to make our customers stronger through all that UNFI can offer them.

Now, let me turn the call over to John.

John W. Howard

Chief Financial Officer, United Natural Foods, Inc.

Thank you, Chris, and good morning, everyone. On today's call, I'll cover our first quarter financial performance, balance sheet, capital structure and comments on our fiscal 2022 outlook. As Sandy and Chris both said, we are

encouraged by our operating performance this quarter and the start to fiscal 2022. Sales for the first quarter totaled \$7 billion, a 4.7% increase compared to last year's Q1. Adjusted EBITDA increased nearly 19% from \$159 million to \$189 million.

First quarter gross margin rate increased 38 basis points compared to last year's first quarter. Our wholesale margin rate was impacted by this quarter's elevated inflation as well as the continued benefits from our Value Path initiatives. First quarter operating expense rate declined 20 basis points compared to last year driven by the favorable leverage from higher sales and lower year-over-year costs when comparing last year's costs related to the consolidation in the Pacific Northwest against this year's startup cost for our DC supporting the New York Metro area. These were partially offset by higher operating cost in our supply chain including transportation costs, part of which came in support of our customers during the temporary and voluntary closure of our Centralia Washington distribution center, the first week of the quarter as well as investments in adding and retaining labor to better service our customers.

As we've stated before, one of our goals is to grow adjusted EBITDA faster than sales and this quarter's 19% growth and adjusted EBITDA on a 4.7% increase in sales exemplify just that and translated to a 32 basis point year-over-year expansion in our adjusted EBITDA margin. Our GAAP earnings per share totaled \$1.25 which included \$0.28 in net favorable items. This includes our GAAP tax rate which benefited from employee stock award vestings as well as the release of various tax reserves. Our adjusted EPS for the quarter totaled \$0.97 per share compared to \$0.51 last year, an increase of 90% further demonstrating our P&L leverage.

Turning to the balance sheet, we finished the quarter with total outstanding net debt of \$2.48 billion, a \$194 million increase compared to year-end. This reflects our customary first quarter investment and working capital as we add inventory going into the holiday selling season in support of our customers, as well as the addition of inventory into our newest distribution center.

The expected seasonal increase in working capital should convert to a source of cash in the second quarter. As expected, our net debt-to-adjusted EBITDA leverage ratio increased slightly compared to the end of fiscal 2021 to 3.2 times as the higher trailing 12 month adjusted EBITDA was more than offset by higher net debt balance driven by seasonal working capital increases. We still expect full year adjusted EBITDA growth and a lower year-over-year growth debt level to push our adjusted EBITDA leverage ratio below three times by year end.

Late in the quarter both Moody's and S&P upgraded our corporate family credit ratings as well as the ratings on our secured term loan and unsecured bonds. We subsequently repriced our term loan at a rate of LIBOR plus 3.25% which is 25 basis points lower than the previous rate. Simultaneously, with the repricing, we drew \$150 million under our ABL facility and made a prepayment on the term loan reducing its outstanding balance from \$994 million at quarter end to \$844 million. These two actions combined are expected to save UNFI nearly \$6 million in annual cash interest expense.

Let's turn to our outlook for fiscal 2022. We are reaffirming our full year outlook for net sales which we continue to expect to be in the range of \$27.8 billion to \$28.3 billion. Our outlook for adjusted EBITDA remains unchanged with a range of \$760 million to \$790 million. And finally, our outlook for adjusted EPS is also unchanged and expected to finish between \$3.90 and \$4.20 per share. We now believe that inflation will be above the 1% level we provided on our last call, but the more prolonged challenges across the supply chain will offset potential sales impact. Our base measure of inflation is the increase to our landed cost of goods which was approximately 4% for the quarter. However, we believe the inflation impact to our net sales as Chris discussed was approximately 2.5% to 3% when we factor in changes in consumer buying habits including mix shifts and certain fresh categories.

Although our sales were impacted by inflation, there are offsets in our P&L that include a higher LIFO charge and increase in certain operating expenses. Our outlook for debt reduction remains unchanged at \$100 million to \$150 million as does our expectation for capital expenditures of approximately \$300 million which as a reminder excludes the amount for the Riverside purchase and sale leaseback transaction which we expect to occur in the second half of the fiscal year.

As you've heard, today's operating backdrop remains challenging, yet, we remain confident in our ability to serve our customers and deliver on our full year guidance.

Before we open up the call for questions, let me reiterate our commitment to increasing shareholder value and delivering the long-term targets presented at June's Investor Day.

Our business model and mission are built to succeed in normal times as well as those we have characterized as more challenging. As Sandy stated earlier, our focus on helping our customers succeed remains at the center of everything we do, and who we are as a company, and we appreciate your continued support. Operator, we're now ready to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from the line of John Heinbockel with Guggenheim.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

[indiscernible] (00:23:37) guys. Let me start with, do you have any way of telling relative allocation in fill rates versus various competitors and retailers, right? Because you would think, you should have a better allocation than smaller distributors and small retailers, do you have a sense of that? And then can that drive new customer acquisition, right, in the short run here because you have product and others don't, or is that too optimistic?

Christopher P. Testa

President, United Natural Foods, Inc.

A

Hey, John, it's Chris. So, it's impossible for us to tell what's going on with CPG allocation of products. What we do is we work with them every day to make sure that we're securing our fair share of supply and given our scale and given that we are the top one, two, three customer for many of these CPGs, we get more product, right, on a straight allocation basis. So, that is what the CPGs are telling us. As far as acquisition of new customers that is an attractive selling point, in addition to, since COVID hit almost 20 months ago, it's stressed the supply chain and what we have found is that our customers are looking for alternatives in this stressed environment. And what we found is UNFI is an attractive alternative not only because of the product availability that you asked about, but also just the consistency in the size and the scale of the network. So that has been helpful for us to attract new customers.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

And then if you think about the pipeline you referenced, right, so the biggest you had I don't think if that's number of folks you're having conversations with or volume that they represent. But if you think about the composition of that, so maybe speak to that, but also the composition large versus small, conventional versus more specialty or even maybe non-food retail, what does the composition look like?

Christopher P. Testa

President, United Natural Foods, Inc.

A

Sure. So, first, to answer your question, it's the volume that represent, so that's how we're measuring that. Look, we are tracking hundreds of opportunities and if you think about what UNFI sells with over 300 SKUs with the deep fresh portfolio, with the deep conventional portfolio, with the deep natural portfolio, brand, services, there is really no single competitor out there. So, the customers – the potential customers in the pipeline are really a range from the large national customers. They range from customers with captive distribution looking for alternatives. There are also a lot and hundreds of local regional customers as well. So, it really is the range John and you know we still look at that \$38 billion opportunity with existing customers as white space as well as the \$78 billion opportunity with new customers. So, it's the – the pipeline represents a fair amount of both.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

And one last real quick one. The Key Food will get to the \$1 billion run rate win. And I guess in the first quarter, what might Key Food have been running at \$100 million plus or something like that?

Christopher P. Testa

President, United Natural Foods, Inc.

A

So, we don't disclose how much we do with each customer, but we won't realize the full volume of the Key Food until fiscal 2023. This ramped up throughout the year, but we won't get the full volume until 12 months next year.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

Okay. Thank you.

Christopher P. Testa

President, United Natural Foods, Inc.

A

Sure.

Operator: Your next question is from the line of Scott Mushkin with R5 Capital.

Scott Mushkin

Analyst, R5 Capital

Q

Hey, guys, thanks for taking my call. Great work given the environment. So, I guess that's the first thing I wanted to ask about is you know obviously, it's really hard right now operating, [ph] we saw in (00:27:47) the Campbell's call and they were talking about how difficult to run some of those plants. So, I was wondering if you guys could talk about what's your expectation is. I know there's a lot of pressure points in the quarter you just reported. How are you thinking about the next couple of quarters as far as availability of labor, just the challenge of running your network, is it going to lessen or is it going to remain the same?

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

A

Yeah, Scott, this is Sandy. I think our outlook is essentially realistic. It's very hard to predict what's around the next corner. As Chris said in his remarks, we made some improvements in terms of our net openings in our fulfillment system. And we are doing that by intensifying our recruiting, but also working on simplifying the

associated experience as well. And as we talk to suppliers, they continue to believe that they are going to have constraints around their supply environment. And so, our general expectation is that we're going to have to stay agile, we are going to have to stay customer-focused and that the environment will continue to be difficult.

Scott Mushkin*Analyst, R5 Capital*

Q

And staffing levels are okay, right now, I'm just looking at the COVID cases are going through the roof, I mean are you able to staff.

J. Alexander M. Douglas*Chief Executive Officer & Director, United Natural Foods, Inc.*

A

Eric, why don't you take that?

Eric A. Dorne*Chief Operating Officer, United Natural Foods, Inc.*

A

Yeah, Scott, we are and we are actively enforcing our protocols around COVID whether it's mask wearing, social distancing, and we continue, we have offered incentives for vaccinations. We're encouraging and educating our staff around the benefits of vaccinations. And as Chris referenced, we closed our head count gap by 30%, and we're continuing to work on that, and associate friendly programs like Flex Shift is really starting to take hold. We're seeing almost 4% of our total hours with those associates and it's growing every week. So, we are focused on it, we're going to stay focused on it and work our way through it.

Scott Mushkin*Analyst, R5 Capital*

Q

Then my follow-up is much more of the longer-term question, I mean I know the thought processes, we're going to do more consolidation of the distribution networks. I don't think you mentioned it, maybe I missed it, but I was wondering where we are in that process, like how are you guys are thinking may be after next couple years on that item?

Eric A. Dorne*Chief Operating Officer, United Natural Foods, Inc.*

A

Yeah, Scott, I'll take this again, it's Eric. We are actively looking at that, but we are focused on meeting our capacity needs probably here and now. So, we have looked at expansions that we have underway, obviously, with Allentown coming online and adding a 1.3 million square feet to service the New York market, and we continue to invest, strategically invest in automation. We've got two new automated systems on the West Coast that we talked about, in Richfield and Riverside, we're expanding our Carlisle PA automation system, and we're looking at other strategic expansions around the network. So, I think this is very much a dynamic situation based on our growth and leading the pipeline that Chris referenced making sure that we can continue to stay flexible and agile as the business comes on.

Scott Mushkin*Analyst, R5 Capital*

Q

All right. Perfect guys. Thanks very much. Appreciate it.

Operator: Your next question is from William Reuter with Bank of America.

William Michael Reuter*Analyst, BofA Securities, Inc.*

Q

Good morning. On the Allentown distribution center, have you talked about how much of that capacity is going to be used by Key Foods? And you've been hoping to get additional customers in the New York Metro area, how has that process gone so far?

Christopher P. Testa*President, United Natural Foods, Inc.*

A

Yeah, so we are focused on that start-up, any start-up that you have for any warehouse, you want to build gradually and work out the kinks as I said we've had some expected challenges there, but we are really proud of the progress and we're just focused on servicing the business we have there, and we will – we do plan to continue to add [ph] service at (00:31:55) very attractive and dense marketplace in the near-term.

William Michael Reuter*Analyst, BofA Securities, Inc.*

Q

Okay. And then, in the prepared remarks you talked about limited product availability and how that's producing promotions. Can you talk a little bit about how the balance of this, I guess how this is negatively impacting margins versus the positive of inflation?

Christopher P. Testa*President, United Natural Foods, Inc.*

A

Yeah, so I'll say this – so, it's first off, the fill rate, we are still growing over \$300 million in the quarter year-over-year and the fill rate was only up slightly. So, there's plenty of product and supply out there, just might not have the SKUs and everything that our customers want because of the supply constrictions. So, we're selling a lot of product, we're doing everything we can to keep our customer shelves filled. Regarding promo, we are seeing it come back, as far as activity, our merchandising teams working closely with suppliers to make sure that we're getting the best promos for our customers, doing everything to mitigate price increases, and we did see a year-over-year increase in promo activity. The fill rate and less new SKUs is a headwind, but overall, we're actually – our promo expectations were in line with what we thought was going to happen for the quarter.

William Michael Reuter*Analyst, BofA Securities, Inc.*

Q

Okay. And then lastly, if I could just squeeze one in. With regards to the one facility that was shut down in August it's now fully operational. Are there any facilities that are getting levels of COVID transmission that you're concerned you may have to shut them down again?

Eric A. Dome*Chief Operating Officer, United Natural Foods, Inc.*

A

Bill, this is Eric. No, we have not seen that, and again I'd reinforce the protocols that we have in place. We've been maintaining mask wearing in all facilities, social distancing, we continue to offer incentives for vaccinations and encourage our associates to get vaccinated. So, we're monitoring, we have a really robust program in place to monitor, and we're continuing to just see the normal trends across the country. So, nothing alarming that we would communicate.

William Michael Reuter*Analyst, BofA Securities, Inc.*

Q

Great. Thanks a lot. And good luck [indiscernible] (00:34:04).

Operator: Your next question is from Bill Kirk with MKM Partners.

Bill Kirk

Analyst, MKM Partners LLC

Q

Hey, good morning, everyone. So, more so than normal, it sounds like customers ordered early for the holidays and maybe expanded their inventories. So, I guess, how big of a benefit was that or how abnormal was that inventory load relative to other like periods and does it reverse out here in later in 2Q? Do their inventories come back down at [indiscernible] (00:34:38) customers?

Christopher P. Testa

President, United Natural Foods, Inc.

A

Hey, Bill, this is Chris. I think you're talking about for the November and Thanksgiving season and the December season. So, this is always – this quarter Q2 that we're in right now always represents our highest inventory build because of the inventory, sorry, because of the holidays. So, it's in line with what we've seen for prior years. Nothing dramatically lower, nothing dramatically bigger. As far as the order early, we started talking about Thanksgiving in July, and that was just to work really closely with our customers and our suppliers to make sure we had those high demand items on their shelves. So, we feel pretty good about our performance in Thanksgiving, there's always opportunities to do better, and we are focused on the December holidays right now.

Bill Kirk

Analyst, MKM Partners LLC

Q

And can I ask as a follow-up, did you see retailers who normally rely on their own captive distribution. Did you see them lean on your services more in the period, and if they were to assume maybe they were having some of their own supply chain restrictions. But if they leaned on you more, did they say or did they go back to their normal sourcing systems?

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

A

Bill, this is Sandy. I'm going to make a strategic point, and then I'll turn it over to Chris to answer your question. I think one of the things we've been paying attention to is making sure that we take care of our customers that exist, while we think about growing new customers. As Chris said, the pipeline is very rich and robust, of all types of customers and you described that. But what matters to us every day, is that the customers who've trusted us before, will get the best possible service, and then we add customers as we have the capability and capacity to do it. And so, Chris, you can get into the detail, but I think the point I want to reinforce is how loyal we are to the customers who've been loyal to us.

Christopher P. Testa

President, United Natural Foods, Inc.

A

Yeah, just to add to what Sandy said, we have not seen a retraction from that new business gains from captive customers that is actually if anything it's going the opposite direction.

Bill Kirk

Analyst, MKM Partners LLC

Q

Okay. Thank you everyone.

Operator: Your next question is from Eric Larson with Seaport Research.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Yeah, thanks everyone. Thanks for the question. So, I would like to dig a little bit more, maybe this is a question for Chris. Into the promotional environment, obviously, the manufacturers are taking prices up aggressively, looks like they might not even – they might even need another round due to higher cost. So, traditionally, that's been a good profit center for you as they increase their promotional discount rates during promotional period. So, has that kicked in fully yet here Chris or do you still expect increased benefits going forward on that?

Christopher P. Testa

President, United Natural Foods, Inc.

A

So, I will say that it has not kicked in fully, and although we are getting those promotions to your point that behavior staying consistent, and what's preventing us from fully kicking in is the product supply, right. So, I mean if you think about promotions, promotions are based on transactions and number of transactions. And when you have less SKUs, when you're on allocation, when you're not launching new product, those transaction levels are lower. The promotions are there, the programs are there, but I would to your question directly about fully kicking in, no, I don't think it has. I think there's been some headwind because of the product availability issues that we're having.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Okay. Thanks. And a little bit more detailed [indiscernible] (00:38:32) on fill rates, obviously, product availability is part of it, has any other part of the supply chain been an issue either. I think you mentioned a little bit about transportation. But is it like 90% just product availability on fill rates or are there other constraints in your supply chain that are restricting that fill rate completion?

Christopher P. Testa

President, United Natural Foods, Inc.

A

No, our fill rate is a reflection of our inbound fill rate from our suppliers. And there is no surprises there. It is labor, it's availability of transportation, it's raw materials, it's all the macro environment factors that you've been hearing about and actually spoke out in the last call. So, there's really nothing unique to our environment, our supply chain that's hindering fill rate it's really about inbound.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Got it. Okay. And then my final question, I think is for John. John, I think you talked a little bit about this at year-end. Your \$300 millions of CapEx spending, I think if I recall quickly that, that is still a little bit of an elevated spending rate for this upcoming year. Is that the case or is \$300 million more of kind of what we should expect going forward?

John W. Howard

Chief Financial Officer, United Natural Foods, Inc.

A

What we've said, I appreciate the question, Eric, and what we've talked about on that is, being roughly around that 1% of sales and we put in for our 2022 guidance, the \$300 million. And just as a reminder, as I said in my

script, that excluding the financial reporting aspect related to how we're going to monetize Riverside as it will give you the impression it's driving that [ph] out (00:40:19) much higher. But that \$300 million, we're still targeting that \$300 million of cash CapEx for FY 2022. We haven't brought that down yet, we're seeing some similar supply chain challenges on some of the projects, but we're continuing to keep that \$300 million out there and doing every we can to make those investments line up with our customer focus.

Eric Larson*Analyst, Seaport Global Securities LLC*

Q

Okay. Thank you everyone.

Operator: [Operator Instructions] Your next question is from the line of Greg Badishkanian with Wolfe research.

Spencer Christian Hanus*Analyst, WR Securities LLC*

Q

Good morning. This is Spencer Hanus on for Greg. Can you talk about your expectations for inflation for the full year? Should we expect the 1Q run rate at 2.5 to 3 to be a good proxy for the full year. And then, how much of a sales headwind were the lower fill rates in the quarter and just how does that flow into the full year guidance as you should see a really significant benefit from the higher run rate inflation?

J. Alexander M. Douglas*Chief Executive Officer & Director, United Natural Foods, Inc.*

A

Yeah, so Spencer, I'll take the first part of that as it relates to the inflation. As I mentioned, we did raise our view on that from the 100 bps and 250 to 300 bps is how we're thinking about certainly in the near-term. But as I mentioned there's also some of those corresponding offsets related to the supply chain and other challenges that we're seeing that will keep the sales in line with where we provided our original guidance.

Christopher P. Testa*President, United Natural Foods, Inc.*

A

And then just as far as the fill rate impact on sales. So, I'll say that – fill rate was up slightly year-over-year and sales were up over 4.5%. So, we have products and that we work with our customers to sell when we don't have the products, the exact products they want, right. So, mainly replacing in stock SKUs from our brands portfolio, which typically has a 5% to 10% more favorable fill rate than national brands. We look for alternatives for our products that are going to be in stock longer-term. So, we are generating the sales for those out-of-stock and constricted items. The exact headwind is, I can't put a number on it, I don't think anybody can, because we work so hard with our customers to control the controllables right, to find the products, to keep their shelves full, and make sure that we're getting the revenue from whatever we have in our warehouses.

Spencer Christian Hanus*Analyst, WR Securities LLC*

Q

Got it. That's helpful. And then just a follow-up on the DC consolidation question. Do you still think that the plan laid out by Steve makes strategic sense? And how long would you expect the consolidation plans to be pushed out. Is it 6 months, 12 months, 18 months, any color there would be helpful?

J. Alexander M. Douglas*Chief Executive Officer & Director, United Natural Foods, Inc.*

A

Yeah, I don't think Spencer we would put a timeframe on it as we're trying to stay agile here and leverage our capacity to service the customers that we have and that we're acquiring. So, I think this is very much a dynamic situation and we're going to continue to leverage our building. And as we add new customers that profile will really change, so I think more to come on that as we move forward.

Spencer Christian Hanus*Analyst, WR Securities LLC*

Q

Great. Thank you.

Operator: Your next question is from the line of Peter Saleh, with BTIG.

Peter Saleh*Analyst, BTIG LLC*

Q

Great. Thanks. Thanks for taking the question. Congrats on the quarter. I just wanted to come back to the conversation around labor and the changes you guys have made to the employee, I guess compensation. I think you guys mentioned there was a 30% reduction and I think it's the gap versus head count gap that you guys are expecting. Maybe can you elaborate there? And then just have you seen any changes in your turnover rates have those come down as you've made changes to the compensation structure? Thank you.

Eric A. Dorne*Chief Operating Officer, United Natural Foods, Inc.*

A

Yeah, Peter, this is Eric. The 30% we referenced is the gap of associates we need to service our business versus what we had. So, we've closed that gap by 30% by doing a variety of things all of which focused on the associate experience, the lifestyle inside the buildings we're striving after worklife balance, reducing overtime, increasing flexibility. So, it's really not just about wages that we've adjusted. We're going after more than that. And other things like early wage access is an innovative program that we put in, throughout the network we've revised our success share plan for inside the DCs, and we've also modified our health benefit options to all associates. So, this is more than just wages. And we're optimistic on what we're seeing. And again this is a focus for us moving forward through this challenging time.

Peter Saleh*Analyst, BTIG LLC*

Q

Great. Thank you for that. And then just lastly on the leverage, I know it ticked up a little bit here. Can we expect or what's the timing you guys anticipate to get to call that 2.5 times leverage? Can we anticipate that you might get there by the end of FY 2022 or is this more of a sometime in 2023 target?

J. Alexander M. Douglas*Chief Executive Officer & Director, United Natural Foods, Inc.*

A

Yeah, so what we put out there Peter is, we talked about getting to the 2 to 2.5 range as part of our Investor Day which would be the end of FY 2024 for us. And certainly, we'll be doing it on a gradual basis, we're forecasting being in below three times at the end of this fiscal year. And we're anticipating at this point, continuing that trend to get to that 2 to 2.5 range by the end of FY 2024.

Peter Saleh*Analyst, BTIG LLC*

Q

Thank you very much.

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

Yeah. Appreciate your question.

A

Christopher P. Testa

President, United Natural Foods, Inc.

Yeah. I think we've answered all the questions in the queue. So, I guess we've one more come in [ph] line, why don't you bring that one in for us (00:46:22)?

A

Operator: And your next question is from Edward Kelly with Wells Fargo.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Yeah. Hi, guys. Good morning. Could you just talk little bit about the rate of labor inflation that you are currently seeing and expect going forward both from like a driver perspective and warehouse perspective, food service has been ramping, hiring, wondering, what's been happening with sort of market pressure there and your expectations around that?

Q

Eric A. Dorne

Chief Operating Officer, United Natural Foods, Inc.

Ed, this is Eric. I'm not sure I put a number to it, but as Chris referenced in his script, we've made market adjustments and will continue to make market adjustments as things continue to evolve here. As far as driver specifically, we've put different programs in place for our drivers whether they're premiums or sign-on bonuses and we feel very confident with our associated profile here on drivers that we offer a different experience than other players in the market and we are going to continue to leverage that as we move forward.

A

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

Ed, this is Sandy. I think what I would add to that is that market competitive is the key and then we're trying to differentiate is to the different lifestyle and employee friendly programs. There's a whole lot of effort going on across Eric's organization to get closer to our team and to make UNFI a better place to work, and through that, to be able to take market competitive investments, which is all about customer capability, but leverage it to get the most value possible out of every dollar spent.

A

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Okay. And then can you just, I don't know, is there any update on retail and strategic outlook for that business, and how it fits within UNFI with the long-term?

Q

John W. Howard

Chief Financial Officer, United Natural Foods, Inc.

Yeah. No, I'm happy to answer that. This is John. Like we talked about it at our Investor Day, we are going to continue to optimize retail. We've got an outstanding leadership team that is in place there, spearheaded by Mike Stigers. And he – with that function, that segment has been performing outstanding both the Cub banner and the Minneapolis market as well as the Southwest banners on the East Coast. And our approach that is to continue to

A

optimize which means we're going to run, we're going to invest, we're going to grow, and we're going to do all the things that you would expect us to do with an asset that we own and at the same time what that means is, if an opportunity present itself to monetize it at an appropriate value, we're happy to consider it, but under the leadership that we have and the results that they're producing we're going to continue to optimize and grow it.

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

A

Yeah, and Ed, Sandy again. What I would also add is it's a great place for us to learn.

John W. Howard

Chief Financial Officer, United Natural Foods, Inc.

A

Yeah.

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

A

Our retail leadership team gives us really direct feedback about what they need and what program, services, brands and other things we can do to serve them better and that visibility very helpful to us.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Q

Okay. And maybe just lastly for you, related to the Chains, you mentioned Chains with captive distribution and making inroads there, can you just provide a bit more color on that? How much of that is just people are looking for product right now versus you building a more sustained relationship in that area?

Christopher P. Testa

President, United Natural Foods, Inc.

A

Hi Ed, it's Chris. I think it's more than just product supply. I think there is retailers with captive distribution that are looking long-term and considering their own capital investment versus leveraging UNFI's network. And given the scale of our network, we can provide an attractive option to them rather than investing on their own, and I think generally that's where it's coming from.

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

A

And I think also, this is Sandy, serving captive retailers is not new. I mean it could be category specific, natural products, different kinds of items that they want to have, innovation et cetera. And so, it's a growing part of the business, but it's not a new part of the business.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Christopher P. Testa

President, United Natural Foods, Inc.

Okay. Thank you, guys for joining us today and for joining us this morning. I hope you've heard and take away from today's call that UNFI is growing and improving within a challenging and unpredictable environment. Like steadfastly focusing on what we need to do, to make our customer successful.

As I said on the last call, our job is to help our customers and suppliers compete, grow, serve their customers, and add value to their businesses across our network. Our success depends on repeating this day in and day out, and I'm pleased with how well we're doing while being challenged by significant opportunities for ongoing improvement. For our customers, we thank you for your continued partnership and the business we do together. And for our suppliers and UNFI associates listening today, our thanks to each of you for everything that you do for our business, our customers, our communities, and each other. And for our shareholders, thank you for the trust you put in us through your continued investment in UNFI. Thanks everyone.

Operator: Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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