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United Natural Foods, Inc. (UNFI)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Cheryl and I will be your conference operator today. At this time, I would like to welcome everyone to the United Foods, Inc. (sic) [United Natural Foods, Inc.] Fourth Quarter Fiscal 2018 Results Conference Call.

[Operator Instructions] Faten Freiha, Director of Investor Relations, you may begin your conference.

Faten Freiha

Director-Investor Relations & Corporate Strategy, United Natural Foods, Inc.

Thank you, Cheryl. Good evening, everyone. Thank you for joining us on United Natural Foods' fourth quarter fiscal 2018 earnings conference call. By now you should have received a copy of the earnings release issued this afternoon. In addition, management will be periodically referring to a slide presentation related to the pending SUPERVALU acquisition during prepared remarks. The press release, the webcast of today's call, and the presentation related to the pending SUPERVALU acquisition are available under the Investors section under the company's website at www.unfi.com under the Events tab.

Joining me for today's call are Steve Spinner, our Chairman and Chief Executive Officer; Sean Griffin, the designated CEO of SUPERVALU once the deal closes and Head of Integration; Mike Zechmeister, our Chief Financial Officer; and Chris Testa, President of UNFI.

Steve and Mike will provide a business update and speak about our performance in the quarter, outlook for the fiscal year 2019, as well as provide additional information on the pending SUPERVALU acquisition. Sean will provide an update on the integration plans related to SUPERVALU. We'll take your questions after management's prepared remarks conclude.

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. Reconciliations to the most comparable GAAP financial measures are included in the schedules on our press release and on the Investors section of the company's website under the Events tab.

I'll now turn the call over to Steve.

Steven L. Spinner

Chairman and Chief Executive Officer, United Natural Foods, Inc.

Thank you, Faten. Good evening, everyone and thank you for joining our call tonight. Before we begin, I'd just like to take a second and thank our associates, our customers, and our stakeholders in the Carolinas who have been affected by Hurricane Florence. We're monitoring the situation very closely, both for them and anyone else affected by the storm, and we're thankful to report that the two distribution centers in the region, we did not have any building damage, product loss, or injury to our associates.

Today, I'm going to start with a few comments on the fourth quarter and full year. Mike will give you more color on results. And then we'll spend some time on SUPERVALU. As noted in our release and as Faten mentioned, we have posted a presentation to help with today's discussion on the pending SUPERVALU acquisition. We are really excited about this transformative transaction to create a new and stronger business, as a leading and premier food wholesaler with significant scale, reach, and choices for customers, existing and new. Sean will provide an update on integration planning, and then Mike will talk about year one performance, leverage, and capital allocation plans. While our prepared remarks are a little longer than usual, we will be sure to answer all of your questions. We'll build on all of this information with a deeper operational and financial review of the combined company when we hold our Investor Day on Wednesday, January 16th, in Orlando, Florida.

Turning to Q4 and full-year results, we continue to see strong growth in our supernatural channel. Supermarkets grew 4% for fiscal year 2018, however growth slowed in the fourth quarter to 1.1%. While we have maintained our customer base, we did experience store closures, brand loss to captive distribution, and a continued hypercompetitive market at retail. The result is that net sales grew more than 10% for the year, within our expectations, but because of the shift in customer mix, specifically faster growth of lower-margin customers and higher inbound freight costs, gross margin was 14.5% in the quarter, down 125 basis points from fourth quarter 2017 and below what we expected. As a result, our full-year EPS was below our revised guidance range.

During our third quarter 2018 call, we raised our guidance for the fiscal year. In hindsight, we were overly optimistic that inbound freight cost would abate and we could pass through these costs in a more expeditious way. Our focus remained on managing increased demand, and as a result, we just could not meet our expectations in these areas during this short period of time; tough timing, but the right decision to support our growth.

Despite the fourth quarter result, I'm proud of our fiscal 2018 numbers. Sales grew over 10% and adjusted EPS grew 21%, or 8% excluding the tax reform benefit.

As we discussed in the past, higher demand pressured our supply chain, as we continue to see degradation in supplier inbound fill rates. Supplier out-of-stocks in the fourth quarter of fiscal 2018 were approximately 170 basis points unfavorable versus the same quarter in the prior year, and approximately 60 basis points unfavorable compared to the third quarter of fiscal 2018.

We continue to be dedicated to working with our suppliers and to enhance alignment on demand signals. While we're disappointed with the acute business headwinds we faced during the fourth quarter, we do believe they're short-term in nature. For fiscal 2019, we believe that we can better manage these headwinds, particularly freight expense, as we expect to pass through more of our freight costs, despite the one to two-quarter timing lag.

As we expected, we're already seeing improvement in our inbound freight numbers so far this year. In total, overall demand for better-for-you products and our compelling customer service remains very robust in an evolving marketplace and we look forward to UNFI's opportunities for continued growth.

With that overview, I'll now turn the call over to Mike to provide you some additional color on the quarter. Thanks, Mike.

Michael Paul Zechmeister

Chief Financial Officer, United Natural Foods, Inc.

Thank you, Steve. Good evening, everyone and thank you for joining us. On tonight's call, I will speak to our fourth quarter performance, provide some additional deals on the pending SUPERVALU acquisition and related capital allocation plans, leverage, and year one financial expectations.

I'll also provide a perspective on UNFI's outlook for fiscal 2019 excluding SUPERVALU. Starting with our fiscal 2018 fourth quarter results, net sales were $2.59 billion, an increase of 10.7% or approximately $251 million compared to Q4 last year. In the fourth quarter, we continued to experience modest inflation of approximately 27 basis points, which was slightly higher than last quarter's inflation of 23 basis points. This marks the ninth consecutive quarter of either modest deflation or near-zero inflation compared to our 10-year average of 2.1%. Given that our customer contracts are predominantly cost plus a percentage markup, the lack of historic levels of inflation continue to be a headwind to our EBITDA dollar growth.

From a channel perspective, fourth quarter supernatural channel net sales accelerated to 27.5% over Q4 last year, and represented 37.9% of total net sales during the quarter. Supermarket channel net sales increased a modest 1.1% versus last year and landed at 27.3% of total net sales for the quarter. The independent channel net sales grew at 5.7% over the prior year, and independents represented approximately 25.1% of total net sales. The remainder of our business declined by approximately 1.5% versus Q4 last year, primarily as a result of the divestiture of Earth Origins retail business. On July 15, we closed on the divestiture of our eight remaining natural food retail stores that operate under the Earth Origins Market banner.

Let me also comment on our food service and e-commerce channels, which have historically been included in our other channel results. Our food service channel represents approximately 4% of our total net sales and grew at 3.6% in Q4 versus Q4 last year. E-commerce represents approximately 3% of our total net sales and declined 2.8% in Q4 versus last year, as we rationalized out some of our less profitable business. Going forward, we will continue to invest for profitable growth on our e-commerce channel, as we are uniquely positioned to add value with our broad assortment, in the right shipment sizes, and at attractive price points.

Gross margin results for the fourth quarter were disappointing at 14.50%, a decrease of 125 basis points compared to the same period last year. The decline was driven by a greater-than-expected shift in customer mix, where net sales growth of our largest customer outpaced growth of other customers with higher margins, as well as an increase in inbound freight costs.

Operating expenses increased $19.1 million to $326.2 million in the fourth quarter, compared to $307.1 million in the fourth quarter last year. The company recorded approximately $5.0 million of acquisition-related costs associated with the pending SUPERVALU acquisition and $4.6 million of restructuring and divestiture expense in the fourth quarter related to the restructuring and subsequent sale of the Earth Origins retail business.

Total operating expenses were 12.58% of net sales for the fourth quarter, a 54 basis point decrease compared to the same period last year. Excluding restructuring and divestiture charges, and the acquisition-related costs, adjusted operating expenses improved by 78 basis points, primarily driven by leveraging of fixed costs and SG&A expense improvements, which were partially offset by increased labor and fuel costs to service demand.

Fuel costs for the fourth quarter of fiscal 2018 increased by 10 basis points as a percent of distribution net sales compared to the fourth quarter of fiscal 2017, and represented 52 basis points of distribution net sales. Our diesel fuel cost per gallon increased by approximately 29.7% in the fourth quarter versus the fourth quarter of fiscal 2017, while the Department of Energy's national average diesel price was up approximately 28.6% during the quarter or $0.72 per gallon compared to the year-ago period. Compared to the third quarter of fiscal 2018, our diesel cost per gallon was up 2.9% or $0.08 a gallon. For the same period, the Department of Energy's national average price per gallon for diesel was up 6.6%.

As a reminder, fuel cost impact us in two ways. For inbound freight, cost increases eventually work their way into our product cost, as either suppliers increase their cost to us, or we increase our freight costs to the suppliers for whom we pick up product. In either case, there is commonly a lag of one to two quarters from the realization of the cost increases to when those costs are reflected in the value of the inventory that is sold to customers. In that interim period where costs are rising, but not yet reflected in our product cost, this is a headwind to our gross margin. This has been the case for us over the past three quarters, as freight rates and fuel costs have been rising. Once these cost increases are reflected in our product cost, we will see the related tailwind to EBITDA dollar growth all else being equal. Barring additional increases in fuel or overall freight costs, we expect to see the recent inbound freight headwinds dissipate in the first half of fiscal 2019 and turn to positive EBITDA dollar growth.

Outbound freight is the second primary way that fuel costs impacts our results. Outbound freight impacts our operating expenses and is naturally hedged by our customer surcharge programs. When the fuel surcharge is in effect, as it has been over the past couple years, the lag from realization of cost changes to reflection in our surcharge program is closer to one month.

Moving ahead, the share-based compensation expense represented 16 basis points of net sales in Q4 compared to 30 basis points in the fourth quarter of last year. On a dollar basis, share-based compensation expense was down $2.9 million to $4.1 million, compared to $7 million in Q4 last year. This decrease was driven by a reduction of performance-based awards, which are determined by actual full-year results.

Other expense was $3.7 million for the fourth quarter compared to other income of $2.1 million for the same period last year. The year-over-year difference is driven by a gain of $6.1 million related to the sale of the company's stake in Kicking Horse Coffee in Q4 of last fiscal year.

Operating income decreased $11.7 million to $49.8 million during the fourth quarter compared to $61.5 million for the fourth quarter of fiscal 2017. Adjusted operating income, which excludes acquisition, restructuring and divestiture charges, decreased $7.8 million to $59.3 million for the fourth quarter, compared to adjusted operating income of $64.4 million for the fourth quarter last year.

Adjusted EBITDA for the fourth quarter was $81 million, a decrease of 6.4% from adjusted EBITDA of $86.5 million for the fourth quarter of fiscal 2017. Adjusted EBITDA margin was 3.12% of net sales, down 58 basis points from Q4 last year. The decrease in operating income and adjusted EBITDA were driven primarily by gross margin headwinds referenced earlier.

Q4 GAAP EPS was $0.64 compared to $0.76 in Q4 last year. Adjusted EPS decreased $0.04 or 5.6% to $0.76 for the fourth quarter, compared to adjusted EPS of $0.72 for fourth quarter fiscal 2018. Q4 2018 adjusted EPS benefited from a lower tax rate due to the tax reform.

We had free cash flow of $149.7 million in fourth quarter of fiscal 2018 compared to free cash flow of $101.6 million in fourth quarter last year. This is the largest quarterly free cash flow in the company's history and it was primarily driven by improvements in inventory and accounts receivable versus last quarter.

Outstanding lender commitments under our credit facility were $884 million, excluding reserves, with available liquidity of approximately $674 million, including cash and cash equivalents. At the end of Q4, our availability under our credit facility was approximately $650.2 million, our debt-to-EBITDA leverage at the end of fiscal 2018 improved to 1.15 times on a trailing 12-month basis and excluding operating leases.

On August 30, 2018, we finalized a new credit facility agreement for $2 billion, which will go into effect upon the close of the SUPERVALU acquisition. Lender group support for this new credit facility was very strong and it will have the same pricing tiers as our current credit facility, which will terminate upon close of the deal.

Turning to our full-year results, the company generated record net sales of $10.23 billion in fiscal 2018, an increase of 10.3% or approximately $952 million over fiscal 2017 results. We experienced moderate inflation for the year at 25 basis points versus deflation of 11 basis points in fiscal 2017. For the full year, adjusted EBITDA was $335.8 million, an increase of 5.3% compared to adjusted EBITDA of $318.9 million last fiscal year. Adjusted EBITDA margin was 3.28% of net sales, down 16 basis points from last year, driven by the gross margin headwinds associated with customer mix and inbound freight.

For fiscal 2018, the company reported net income of $165.7 million or $3.26 per fully diluted share, an increase of approximately $36 million over prior year. As Steve mentioned, adjusted EPS increased 21% or $0.54 per share to $3.11 compared to adjusted EPS of $2.57 last fiscal year. Capital expenditures for fiscal 2018 were approximately $44.6 million or 0.44% of net sales, which was lower than our expectations, as we have delayed certain projects, primarily in IT, in anticipation of the SUPERVALU acquisition. For fiscal 2017, capital expenditures were $56.1 million or 0.61% of net sales. And over the past five years our capital expenditures have averaged approximately 1.1% of net sales.

Next, I'd like to cover our fiscal 2019 guidance excluding the pending SUPERVALU acquisition. For fiscal 2019, we expect continued strong net sales growth, with moderated EBITDA margin dilution versus fiscal 2018, and strong adjusted EPS growth. On a comparable 52-week basis, we expect our net sales to grow by 6.5% to 8.4%, due primarily to lapping the strong growth from our largest customer.

On a comparable 52-week basis, our adjusted EPS is expected to grow in the range of 10% to 12% over fiscal 2018. Please note that our GAAP EPS incorporates $9.6 million in one-time SUPERVALU deal and integration-related costs, which we would expect to incur if the acquisition did not close in fiscal 2019 as expected. Capital expenditures are expected to be 1.5% to 1.8% of net sales, driven by capacity expansion projects. We are committed to these particular capital projects with a strong financial returns, with or without the impact of the pending SUPERVALU acquisition.

Fiscal 2019 free cash flow is expected to be $40 million to $70 million, with working capital growing at a slower rate than net sales. For more details on our fiscal 2019 guidance and the specific impact of the 53rd-week on our expected fiscal year results, please refer to the table in our press release from earlier today.

Now, let me turn the call over to Steve to talk more about the SUPERVALU transaction.

Steven L. Spinner

Chairman and Chief Executive Officer, United Natural Foods, Inc.

Thanks, Mike. And turning to SUPERVALU. Our operating environment continues to evolve rapidly and we believe that the acquisition will better help us meet the growing needs of our customers. By expanding our product offerings and leveraging our cost base, we will be able to add additional scale, which will enable us to grow and deliver value for shareholders. Combined, UNFI and SUPERVALU will be what we believe to be the premier U.S. food wholesaler.

We will have, after the combination, over 60 distribution centers, 250,000 SKUs, and more than 5,700 private label brands. And we will be providing high-demand products and value-added services to over 45,000 customers, including in-store and general administrative back-of-the-house programs to retailers. With over 3 billion in fresh produce and protein sales across the country, in addition to our center-store expertise, we will have built out our store offering, enabling all of our combined customers access to the widest variety of products in an economically attractive way.

We are focused on helping our retail customers across all channels with broader product offerings and with merchandising, data analysis, and category management. On a combined basis, we expect UNFI and SUPERVALU to achieve greater scale which we will put to work to further build out the store to both new and existing customers.

Let's now turn to our synergy projections. I want to emphasize for you what we expect, and how we expect to get there. Based on our current assessment, we believe we can achieve cost synergies of more than $175 million by year three. In addition, we are expecting additional sales and other related synergies which we will discuss in more detail during our Investor Day, and once we've had more time to fully understand the opportunities.

If you turn to the presentation on our website, I'll walk through the slide now. I'm starting with page 3. As you can see, with SUPERVALU, we are creating an industry leader, combining the best of both UNFI and SUPERVALU. The combination, when closed, offers significant upside resulting from large, identified and achievable synergies, and gives us a path for long-term growth. This is a game-changer for us and for our industry.

We are really, really excited to create North America's premier wholesale distributor. We're confident that we're going to deliver $175 million of cost synergies and we're excited to talk more about that in January. We're excited to continue to cross-sell our better-for-you natural organic brands into SUPERVALU customers and further build out the store with produce and protein across the country, something that we've been talking about for many years.

We've got a very experienced management team with a lot of wholesale and natural organic experience from both UNFI and SUPERVALU. We're going to pick the best of both. And we're also going to look outside the company where we need to, in terms of our board as well as our executive experience, as we build a bigger business. And we're going to create long-term shareholder value using the discipline that we've managed over the last five years, as it relates to capital allocation and capital expenditures.

Turning to page 4, the combination creates compelling and tangible value for all of our stakeholders. For our customers, it allows us to be more meaningful and valuable long-term partner. For our shareholders, the cost synergies create real value, and our scale and reach and capabilities of the combined company set us up to win in the long-term. We've talked about synergies and we'll talk a lot more about synergies. $175 million of cost-related synergies, and we'll share more synergy information as it relates to greater opportunities in January.

Diversification of our customer base, our customer concentration and our largest customer in the combination becomes 18%. We now have a large customer base in supermarkets, with strong demand for our products, foods with better-for-you product attributes. We greatly expand our market reach and scale, and scale drives cost efficiency. We've always had a model that says we're going to lower our costs at a rate that's greater than the decline in the gross margin, and scale is the greatest enabler for that.

Technology, proven technology platforms both from UNFI and SUPERVALU will be deployed across the network.

Turning to page 5, shows the geographic reach of the combined company, and we think it illustrates well the significant opportunity to increase efficiencies in areas where our networks overlap. No one is closer to the customer and no one has greater SKU offerings across the most in-store categories throughout the center of the store and the perimeter in our retailer locations. In distribution, scale wins. 60 plus DCs, close to the consumer, all products that further build out the store, larger drop sizes, with more products delivered to our customer, closer to the customer, is what drives success. It's what retailers today demand, and it's what we'll have.

One of the key benefits of bringing the two companies together, as you can see on page 6, is that how it dramatically increases our customer diversification. Supernatural channel which consist solely of whole foods will represent 18% of our net sales on a pro forma basis compared to close to 37% in fiscal 2018. And, again, looking at page 6, the other important commentary is that the average customer relationship across all of our customers, probably the top 25 customers, spans over 20 years. There's little turnover in our customer base. And, as importantly, we have complementary customers with complementary SKUs and services.

In addition to the benefits of customer diversification, the low level of existing customer overlap, as I said, provides a growth opportunity over the long-term through expanding our relationship with customers by offering a broader selection of SKUs. While cross-selling clearly represents a long-term opportunity, I'm going to focus today on providing you with more detail on cost synergies. Prior to our announcement and in diligence, as you would expect, we did a lot of modeling around synergy opportunities, and we have continued to refine our plans, and with the assistance of PwC, our integration consulting, we are working on plans to integrate efficiently, while taking into consideration both companies' unique market positions, which Sean will speak to shortly.

On our announcement call, we estimated that we will be able to capture more than $175 million in synergies by year three. We've continued to refine our view, and we now believe that we can achieve cost synergies of $175 million in year three and $185 million in year four, as I noted earlier. We have a robust plan and team in place and we're delighted that Sean Griffin is energized to lead this effort as the Incoming CEO of SUPERVALU. Sean has more than 30 years of industry experience, and with him at the helm, we have a high degree of confidence that we'll be able to capitalize on the synergy opportunities and realize the full potential of this transformative combination. As we work through the integration, our plan is to take the best practices, systems, and technologies from both companies to improve operational efficiencies, customer service, and product levels and corporate functions.

I'm now going to turn the call over to Sean, who'll give you a little more color on integration planning. Sean?

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

Terrific. Excuse me. Thank you, Steve and good evening everyone, welcome to the call. And, yes, we've been hard at work on SUPERVALU's integration planning and we feel really good about the progress that we've made so far. As Steve has noted, we have retained PwC as advisers through our integration planning, and we have developed a very solid plan.

As is referenced in slide 9 of the deck on integration planning, we have assembled a strong team of associates, leading various functional work streams from both the UNFI and SUPERVALU organizations. These teams and functional work streams are now moving through the process of discovery to evaluate the current UNFI and SUPERVALU operations. Our mission is to run the combined businesses successfully beginning on day one and to accelerate momentum through the first 100 days post-close.

We believe that there are many opportunities to benefit from even on day one, not limited to but by example only, indirect spend. Indirect spend is the procurement of non-saleable, non-inventory goods and services, such as fleet, material handling equipment, IT services, and any third-party suppliers or supplies. The opportunity to aggregate the purchasing strength of both companies to lower cost is significant, and only an example of the upside.

We are adhering to an integration timeline and building specific milestones along the way to maintain control and governance with clear accountability for our first 100 days and then forward. Our integration team is fully staffed with experienced subject matter experts, with appropriate advisory resources to manage the integration timeline, and most importantly, the expected deliverables.

Let me take a look at some specific areas of opportunity. Steve talked about certainly rationalizing duplicative SG&A costs. Think about the additional assets and scale and optimizing the combined companies inbound and outbound transportation expense. Now with 60 distribution centers, we will need to consolidate and optimize our network. And harmonization of direct supplier agreements, oftentimes referred to as commercial terms and other third-party agreements.

We expect that executing on these efficiencies will deliver synergies, and improve the profitability and efficiency of our company over the long-term. We will leverage scalable systems to streamline our processes, more efficiently meet the needs of our customers, and reduce future capital expenditures. We really have a unique opportunity here, to take the best – the very best of each company and that includes talent, process, and systems, and a combination of the best capabilities to serve a very broad customer base. Importantly, through this combination, UNFI will be positioned to realize run-rate cost synergies of $175 million by year three.

I'd like to talk a little bit about the SUPERVALU's underlying business. SUPERVALU's business has been impacted by a number of factors in recent years, primarily driven by challenges associated with running owned retail banners. And, as you know, we are committed to selling these assets. We know wholesale. It is our core competency at United Natural Foods and we think we're pretty good at it. And we believe in the strength of SUPERVALU's core wholesale business, which they've worked hard at building over these last several years.

SUPERVALU's wholesale business is solid, with many talented people who we expect to complement UNFI's team. The SUPERVALU team is prepared and ready for this integration. And, in fact, they already have developed integration muscle in their organization through previous acquisitions and follow-on integration. They have efficient distribution centers, some of which are automated, and they have demonstrated their ability to take cost out and become more efficient and productive. SUPERVALU has great expertise in high velocity SKUs and other high-growth perimeter categories such as meat, deli, and produce. Very complementary in the combined company and will be valuable in realizing anticipated growth synergies ahead.

In addition, through the integration process, we are learning a lot about SUPERVALU's culture and it's extremely interesting, the alignment pointed towards better serving our customers. The opportunity to bring these two companies together is really incredible. It's bold, it's a transformative transaction, and we believe it will position the combined company well into the future, in creating the right value proposition for our customers, our associates, and our long-term shareholders. And I certainly look forward to working with both teams, United Natural Foods' team and the SUPERVALU team, and making this vision a reality. Thank you.

Steve, I'll turn it over to you.

Steven L. Spinner

Chairman and Chief Executive Officer, United Natural Foods, Inc.

Thanks, Sean. I'm going to go back to the deck and we're going to start back up again on page 7 of the presentation, where we outline our expectations on the bucket of synergies, our target and expected one-time costs. We've broken them into two primary categories: operational and overhead. And you can see that we've set a reasonable expectation of the time to achieve the synergies with 25% in year one, 65% in year two, 95% by year three, and 100% by year four.

For one-time costs, we expect to incur the bulk of the costs to achieve the cost synergies in the first two years, with a tail in years three to five, primarily related to the integration of IT systems as we take the best of both systems and deploy them across the combined network. And one important note on page 7 is that the synergy estimates that we're quoting are incremental to SUPERVALU's assumed synergies from the last two acquisitions that they've made, primarily.

Turning to page 8, we lay out more detail around our major areas of synergy. First, overhead optimization, which accounts for approximately 66% of the synergy. The largest opportunity is streamlining and removing duplicative SG&A costs, followed by rationalizing contracts and consolidating IT spend, which has both an operating and a CapEx benefit. The second area of synergy, representing 34% of the target, is related to operational efficiencies. And as you saw from the map on page 7, our expanded distribution network, as a result of this combination, provides opportunities to use excess capacity by relocating third-party inventory to our distribution centers. We will streamline our DCs by consolidating in markets where we overlap, reducing the direct costs of the DCs and also by allowing us to optimize transportation costs and increase distribution center productivity.

The last area of synergy I'll point out today is CapEx. I've already mentioned the benefit of reduced IT CapEx in the combined company. We will also avoid incremental CapEx that we had planned to deploy to upgrade the UNFI IT systems. Additionally, with broader distribution, UNFI will avoid the need to build out additional DCs to support the strong growth within the natural and organic business.

Before turning the call back over to Mike, I'd like to address SUPERVALU's retail business and our plans to divest it. Moving to page 10 on the deck, we believe SUPERVALU's core distribution business is strong, combined with UNFI's core distribution business, the resulting combination is powerful. From SKUs to scale to perimeter, services and center-store, we will be the premier food wholesaler.

Running retail banners just is not our core business, and we have been clear since announcements regarding our plans to divest. Divesting these retail assets is complex and SUPERVALU is already at work on the process with the sale of Farm Fresh. In addition, earlier this week, SUPERVALU announced the sale of 19 Shop 'n Save stores in the St. Louis market to Schnuck Markets. The transaction is planned to occur with a staggered close process that's currently expected to finish by late October 2018 subject to customary closing conditions.

And as we move forward with the divestiture of the remaining retail banners and stores, our goal will be to proceed in an expedited manner but with a focus on maximizing value, including paying careful attention to the impact of supply agreements and capacity needs. We have teams hard at work to achieve the best outcome, and where applicable have engaged third parties to assist. We're confident that we'll be able to exit the retail business successfully and we'll provide you with more detail at our Investor Day.

I'm now going to turn the call back over to Mike who will go through our thoughts on leverage and capital allocation, Mike?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

Thank you, Steve. As you have heard from Steve and Sean, the acquisition is strategically compelling and positions us well for future growth and value creation. Now I'd like to touch on the information included on slides 11 through 13 and cover year one expectations for the combined companies, including capital allocation plans, debt structure, and leverage.

In the first full year after the acquisition closes, we expect combined company net sales, excluding retail and discontinued operations, to be approximately $24.2 billion to $24.8 billion. Year one adjusted EBITDA is expected to be $655 million to $675 million, excluding retail, one-time deal and the integration-related expenses. In addition, we expect a low double-digit percentage increase in adjusted EPS versus our fiscal 2019 guidance, excluding one-time costs and the impact of purchase accounting.

After year one, we continue to expect double-digit adjusted EPS growth, excluding retail, one-time costs, and the impact of purchase price accounting. As Steve noted, we'll be giving you more detail on our long-term expectations at our Investor Day in Orlando on January 16.

Cost synergies are the primary value-driver in this transaction. As we move forward, we're focused on a successful integration and delivering these cost synergies. As Steve mentioned, we are expecting to achieve more than $175 million in cost synergies in year three and achieve our run-rate cost synergies of more than $185 million in year four. These assumptions exclude growth synergies and are in addition to the synergies expected from SUPERVALU's acquisitions of AG Florida and Unified Grocers.

As we have continued our confirmatory diligence process, we're increasingly confident in delivering these synergy assumptions. While we're not depending on growth synergies to be a large driver of value in this deal, we continue to believe that there are significant opportunities as we have outlined. Once the deal is closed, and we've spent more time with customers, we'll provide more specifics.

From a capital expenditure standpoint over the long-term, we expect the combined company's CapEx, as a percentage of net sales, to be approximately 1.0% of net sales, which excludes capital growth assumptions related to optimizing our capacity and IT spending going forward. Our capital expenditures for fiscal 2019 will be focused on the expansion of distribution center capacity in certain geographies and integration efforts related to the pending acquisition of SUPERVALU.

From a capital allocation standpoint, we will remain disciplined as we focus our efforts on the SUPERVALU integration and reducing leverage. We will forgo M&A opportunities in the near term, we will also forgo share repurchase until we meet our long-term debt and EBITDA leverage target of 2.0 to 2.5 times, excluding operating leases. We will actively manage our working capital to enhance cash flow by ensuring that working capital grows at a slower rate than net sales.

We will continue to invest in the business and use the expected strong free cash flow from the business to pay down debt, which will be almost entirely pre-payable. At close, the debt-to-EBITDA leverage for the combined companies is expected to be approximately 4.7 times. This calculation is based on the total trailing 12-month reported adjusted EBITDA from both companies, including retail, SUPERVALU's Albertsons TSA and approximately $3.5 billion in total debt. Excluding the impact of the outgoing Albertsons TSA, we expect to reduce total enterprise leverage by two turns within the first three years after closing.

The combined companies' normalized debt-to-EBITDA leverage is expected to be 3.9 times at the close of the deal. This calculation excludes the EBITDA impact of the outgoing SUPERVALU TSA and retail business, while including the full-year impact of the AG of Florida and Unified acquisitions. It also includes the additional expense associated with SUPERVALU's recently completed sale leasebacks, as well as the year four run-rate cost synergies of $185 million. For additional details on the leverage calculations, please refer to slide 13 of the presentation.

In summary, we are very excited about the potential of this combination by bringing together the best of both companies across capabilities, processes, systems, and talent, we have an opportunity to deliver superior outcome for our shareholders, customers, suppliers, and associates. I look forward to the deal closing and providing you with more details at our Investor Day in January.

At this point, I'll turn the call over to Steve for closing remarks.

Steven L. Spinner

Chairman and Chief Executive Officer, United Natural Foods, Inc.

Thanks, Mike. Before I wrap up, I do want to acknowledge and thank our UNFI associates who have worked around the clock throughout 2018 to keep up with our very high growth rate. From drivers to warehouse associates and logistics team, to operations management, these are the associates who exhibited leadership, poise, and dedication throughout this time. I would also like to thank all of our associates and SUPERVALU associates who are working on the integration planning. I'm very proud of our people. UNFI associates and our management team have continuously demonstrated their dedication throughout this period and have worked tirelessly to provide exceptional service in a dynamic, changing retail environment. Their work is exceptional.

In summary, we believe this is an exciting time for UNFI. Our industry's evolving, and we are changing with it to meet the needs of our customers and grow together. Scale, supply chain, and people are what differentiate distribution options, together are poised to help retailers drive down cost and increase consumer traffic. Consumer demand for the products we sell is robust and we have a strong pipeline of exciting opportunities ahead. We believe our combination with SUPERVALU, demonstrated leadership with better for you distribution will provide long-term growth opportunities and enable us to achieve our goals and long-term objectives.

At this point, I'll turn the call over to the operator to begin the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Edward Kelly of Wells Fargo. Please go ahead, your line is open.

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Q

Yeah, hi, good afternoon, guys. I want to just start off on SUPERVALU. Can you talk about the biggest challenges associated with integrating these businesses given the diverse SKU base? How much change operationally is going to be required to capture synergies? How much risk is there within the integration, and how do you mitigate that to the best of your ability?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, so I'll start it off first, Ed. I mean, we have hired PwC, which we mentioned in our commentary, and PwC has a terrific and very disciplined plan for developing the strategies for bringing the two companies together, identifying the synergies, balancing the risk, and putting us in a place where we can really win. We can do it right, we can be consistent with our culture, but we can run the plan and run it in a way that balances the risk associated with capturing the synergies. Sean?

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

Yeah. Ed, the way that I see it in terms of having spent a lot of time looking at the diligence and now that we're in the planning stage, we feel really good about where the, let's call them the buckets of opportunity lie. I would say that, we were cautious in sort of thinking about the phasing. And so the timing of the synergies really is, frankly, what we need to deliver on. That's what we need to focus on. We know where those opportunities lie, we know what the SG&A looks like, we know what our plan looks like in terms of having 60 distribution centers and what the best path forward is in terms of optimization. And we sort of took an approach, where we're only looking at 25% in year one, 65% in year two, and then 95% in year three. And so the short answer is timing.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, I would also add that if you were to ask me that question a month or so ago, I would have said I would have been a little bit more worried about retail, given that it's just not something that we're particularly – well, we don't have a competency in retail. But now that we've gotten a chance to really get into it, look under the covers, meet some of the SUPERVALU people who are really tasked with divesting these assets and certainly consistent with the announcement earlier this week on the sale to Schnucks, I'd say I feel much better about our ability to divest ourselves of retail in a really reasonable and economic timeframe.

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Q

And then just a follow-up, Steve, just taking a step back and strategically thinking about the acquisition and what it says about how you're thinking about the business, you're increasing your exposure to independent and regional supermarkets, decreasing exposure to the higher growth but lower margin Whole Foods business, I guess, what does the merger say about the Whole Foods contract long-term, the optimal mix of this business over time? Is it as simple as just putting the two businesses together, getting the synergies and that's our margin, or is it more complicated than that?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, I mean, I think, I would answer in couple ways. Retail world is shifting, and changing, and there has to be consolidation. And, I think, my view is I wanted to be at the front end of it as opposed to the back end of it, number one. Number two, scale is what drives the day in distribution. Scale drives the day, having big distribution centers, where you run a lot of volume through them, gives us the ability to lower cost, be more efficient, higher service to the customer, closer to the customer. And quite frankly, scale is, like I said, is what drives the day. We have to be bigger, we have to be closer to the consumer. And we have to drive more volume through our DCs.

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

Yeah, I would just add that no one is suggesting that it's not complex, so that this proposition is simple to execute, right? However, when we think about the grocery retail environment, the four walls of a retailer, this combination puts us in a position where we can win in every department in a retail store, retail grocery store. And then beyond, there are some very interesting and compelling service offerings in the SUPERVALU arsenal today that when we think about UNFI's independent customer base, there's a lot of value in these back office, transactional, financial, transactional, payroll services that our independent customers don't have the scale to win those services at a low cost. And so we have a lot of opportunity, have a great deal of traction and stickiness with a much broader customer base.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

And just specific to your question, Ed, about independent supermarkets, one of the things the independent supermarkets desperately need is far greater access to the items that UNFI is particularly good at. And so there's a tremendous amount of selling synergy associated with selling our products into the existing SUPERVALU customer base.

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Q

Great. Thanks, guys.

Operator: Your next question comes from the line of John Heinbockel of Guggenheim Securities. Please go ahead. Your line is open.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

So, Steve, if you look at your core business and SUPERVALU, take out synergy on their side, in the margins, profitability's been under pressure, right, for a little while now. How much of that do you think is transitory, freight-related, getting your arms around demand? And how much more secular, right, when you think about mix? And on the secular piece, what do you think both you and they need to do to stabilize profitability in the core business?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Well, let me try the last one first.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Yeah.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

So, obviously, one of the – I mean, I think you asked me without synergies, but, obviously, one of the primary...

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Yeah.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

...synergies on commercial terms, right, bringing companies together and taking a look at commercial terms and making sure we're getting the best of both. Indirect procurement is just a really significant synergy in acquiring fleet, material handling equipment, inbound freight and so on and so forth. And then there are things that we do really well that they don't, and there are things that they do really well that we don't. And so, in the short-term, that's the low-hanging fruit that we really, really need to get our hands around.

As it relates specifically to freight, for us, because, obviously, I can speak a lot more confidently about our view on freight, as opposed to their view on freight, is we were just slow or slower than we thought we would be in passing through, number one, the fairly significant increases in the inbound cost. And two, I think we underestimated the rate of increased freight cost that we incurred in the quarter and as a result, didn't pass through. So I think it's a timing issue. We just got caught behind the eight ball a little bit and I feel pretty good it's not going to happen again.

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

I'd just add, John, that...

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Yeah.

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

...UNFI's model in terms of inbound freight, we have greater exposure to the volatility of the market. We manage approximately 40% of the inbound tons. SUPERVALU has a different model, and it's, obviously, more CPG, more conventional, it's more supplier-delivered. And so when things are attractive in the market, the exposure that UNFI has to this model is beneficial to our gross margin. And what we saw in Q3 now into Q4, of course, is the reverse and we missed it. We missed the rising costs. We certainly had a plan to phase in the freight increases, and we did, they just didn't get there against the costs. Now, the good news is that we are beginning to see that now print in the early innings of our – opening up our FY 2019.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Okay. Then maybe secondly, you talked about consolidating DC capacity. Maybe, order of magnitude, what are you thinking about in terms of maybe square footage? And then one of the problems for both of you, I think, right, was capacity to handle the growth. Do you sort of run the risk if you shut down some of that capacity that you need it for growth or maybe you just think it's in the wrong places, what's your thought on that?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah. So on the first question, John, we'll give you more color about network and consolidation of DCs when we get together in January. We're not going to have a lot of detail on that yet because that's just going to take some time to really understand.

The good news, and there was some commentary on this, is, we spend a lot of money in offsite storage. In other words, we don't have the capacity in the DCs, and so we're forced to either store product in trailers that are really inefficient or we have to rent space at public warehouses and transport it back to our DCs on a daily basis, really inefficient, really expensive. So, right out of the gate, we're going to get out of public storage wherever we can and we're going to get out of the trailers wherever we can and that's a huge win. We also have a couple of markets in the U.S. that we're at capacity. And so, when a customer says, hey, we'd love you to do some additional service, distribution, our answer unfortunately has to be, you're going to have to hold until we have some capacity within that market. And with the addition of the new DCs, we no longer have that issue.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Yeah. Thank you.

Operator: Your next question comes from the line of Karen Short of Barclays. Please go ahead, your line is open.

Karen Short
Analyst, Barclays Capital, Inc.

Q

Hey, thanks. A couple questions, just on guidance and I realize it may be irrelevant shortly once this closes but, it seems to me that at the midpoint of guidance here, EBIT margins are really only slightly contracting. And I know you talked to some puts and takes but that just seems very optimistic and, I guess, I ask it in the context partly in freight because last year when we had the hurricanes, that was kind of the start of the freight issues and it just kept kind of getting worse, even well beyond the hurricane impact. So could you talk to that? And then I had another question on the acquisition. Thanks.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Well, I'll take the freight and then Mike, you can take the margin. For us, the freight issue is an inbound issue. And we move a decent amount of the inbound freight on our own trucks. Slightly up – a little less than 50%, about 40-some-odd-percent we move on our own fleet. The rest we do through contract labor. And so I think it's – and, again, on the outbound to the customer, we're fairly hedged there because we have fuel surcharges that cover those increases. So, on the inbound side, it's more a timing issue than anything else, Karen. So when we get the increases, we pass them through. It just – unfortunately it takes one or two quarters to do that. And the rate of increase in Q4 was just far greater than we thought it would be but we expect that to come back.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, just to add to those comments, Karen, the margin dilutes a little bit in fiscal 2019, in the guidance, as you suggest, but the story really is that inbound freight piece that we talked about. That's the improvement that we'll see going forward. And as we alluded to, we're already seeing some of that benefit come in.

Karen Short
Analyst, Barclays Capital, Inc.

Q

Okay. And just, sorry, on your actual e-commerce slowdown, can you maybe just quantify what the impact of rationalizing the e-commerce customer was on the growth rate? And then I did have one question on the acquisition.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, so it wasn't any one particular e-commerce customer. So if you remember a couple of years ago, we went through a very careful analysis in our food service business and took a look at just those customers we could no longer deliver or we could no longer serve and we either increased the price or we dropped out of delivery because we just couldn't make it work. And quite frankly, we hadn't done that on e-commerce and we did that in this particular quarter. So I think it's more timing than anything else. Chris, talk a little about...

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

A

It's also just – well, also just an incredibly dynamic environment, e-commerce, with huge swings up, huge swings down. And remember it's 3% or less of our business. So as far as our own e-commerce operations, Honest Green, we continue to invest in that. We saw triple-digit growth in Honest Green and that is when we're doing fulfillment on behalf of the customers with our own e-commerce operations continue to grow.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, I think it's more timing than anything.

Karen Short
Analyst, Barclays Capital, Inc.

Q

Okay, and then just on – I get it, scale is what matters in distribution, but you talked to larger drop sizes, and I guess what I'm confused about is why would you end up with larger drop sizes just because you have scale when you don't have really any overlapping customer base between the two assets?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, so it's really a matter of, if you think in terms of not today but in the next couple years, the DCs are going to be blended. So DCs will likely be split by fast-moving and slow-moving. And so we will be delivering a very broad mix of SKUs to our customers. So if they buy protein, produce, center-store, frozen, refrigerated, dairy, it's all going to come on one truck.

Karen Short
Analyst, Barclays Capital, Inc.

Q

Okay. That makes sense, thanks.

Operator: Your next question comes from the line of Scott Mushkin of Wolfe Research. Please go ahead. Your line is open.

Michael Otway
Analyst, Wolfe Research LLC

Q

Hey, good evening, everyone. This is Mike Otway in for Scott. I appreciate you taking the questions. I guess, first on the supermarket side, the business slowed in the fourth quarter. Steve, you gave a few highlights as to kind of what transpired. Any other color there? And what are you guys anticipating for next year? Are you anticipating a pick-up in that business?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, I mean, so what I talked about is that the quarter, again, a little bit of timing. Again, we did have some store closures. Not business we lost, it's just existing customers that closed stores. Not as many store openings than we thought, obviously. And again, we have this dynamic of as SKUs start moving faster, they go to captive, where a captive is available. But, again, that's more timing than anything else. We're not really in a position to provide any color around guidance on conventional for next year, but remember SUPERVALU's largest customer group, independent supermarkets. And one of the things the independent supermarkets need the most are the products that we have. And so one of the greatest certainly growth opportunities outside of the cost synergies are associated with us selling our existing better for you products into SUPERVALU's existing independent supermarket customer base.

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

I would just say that, to recognize that we did have a deceleration in the supermarket channels in [ph] the fourth quarter (01:10:05), on a full year basis, we actually did pretty well in the supermarket channel and met our own internal expectations at about 4%.

Michael Otway
Analyst, Wolfe Research LLC

Q

Got it. Thank you both for that. And then, I guess, Mike, a quick clarification question in terms of pro forma accretion. I think in the slide deck that you guys had following the deal announcement, it was just accretion in year one and now it looks like it's low double-digit accretion, so it looks like that has improved. Can you just give a little – am I right in that? And if so, what's driving the improvement there?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, we just wanted to provide a little more clarity on what that was. We had said significant the last time we were out so, now we're seeing a low double-digit EPS accretion on an adjusted basis, excluding the one-time costs and purchase price accounting over the fiscal 2019 guidance that we just provided for EPS.

Michael Otway
Analyst, Wolfe Research LLC

Q

Got it. So has it improved a little bit or is it about the same, it's just kind of language?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, it's very similar to what we were looking at before.

Michael Otway
Analyst, Wolfe Research LLC

Q

Got it, thank you.

Operator: Your next question comes from the line of Kelly Bania of BMO Capital Markets. Please go ahead. Your line is open.

Kelly Ann Bania
Analyst, BMO Capital Markets (United States)

Q

Hi, thanks for taking the questions. Wanted to just ask about the guidance for sales next year. I think what you're saying on a 52-week basis is about 6.5% to 8.5% growth. And, I guess, just a decent moderation from this year so was curious if you could explain why – what you're expecting to moderate and if there's any color you can provide on mix, which sounds like it continues to be a surprise with your largest customer and how we should think about what kind of mix is embedded in your guidance for next year.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, Kelly, this is Mike, thanks for the question. So first of all, the 52-week comparable guidance is 6.5% to 8.4% growth. And so, as you know, we've got a 53rd week next year, so that makes the growth 8.6% to 10.5% is the comparable 53rd week. Now, in terms of that, compared to the 10.3% growth we had here in fiscal 2018, you have to remember for our largest customer, we're lapping a variety of product categories that we brought into that customer as we built out the store there. And so that mitigates a little bit of that growth trend that we saw.

Kelly Ann Bania
Analyst, BMO Capital Markets (United States)

Q

Okay. And so, any other color on the mix that is embedded in your guidance for the year?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

No. Like I said, we continue to expect our largest customer to have a strong growth rate but not as strong as what we saw in fiscal 2018.

Kelly Ann Bania
Analyst, BMO Capital Markets (United States)

Q

Okay. And, I guess, another question on SUPERVALU, as you've looked at the customers, you've talked about there is pretty minimal crossover. But are those – SUPERVALU's customers using a different natural and organic supplier or are they not using a natural and organic supplier at all? I'm just wondering where the opportunity could come from if they're already under certain contracts, or it would be a new relationship for those customers.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, so it's going to be really different by geography, by customer. There are some customers that, I think, just have a very limited selection of the items that we sell for whatever reason and I think we can really help those customers have a much broader product offering to place in the stores. That's what we do really well. And I think a lot of this kind of customer-level detail, we're going to have to get into in a much bigger way once we close. And I think our plan would be to share a lot more of the detail around the growth opportunities with you in January at the Investor Day.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

And just to add to Steve's comments, there's efficiency here, too, to consider. And today, for our kind of products to make it to those customers, they may have to do it through a cross-dock operation or a less efficient manner to get to the customer at the end. And so one of the opportunities here is even if it is some of the same SKUs, that we can get it done more efficiently.

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

Yeah, I mean, it's a broader portfolio of offering that this particular broad customer base may not have access to.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, I mean, again, I think the reason that scale wins here is today the more a retailer, conventional retailer in particular, can buy from a singular source, the better it's going to be for them. It just drives down their cost overall. It reduces pressure in the back of the store to receive more and more invoices. And so, certainly the message we're hearing from customers and the pressure that we're hearing from customers is please, sell me more of the store, whether it be conventional, whether it be produce or protein, I need to aggregate my purchases, less trucks, more scale, lower cost.

Kelly Ann Bania
Analyst, BMO Capital Markets (United States)

Q

Okay, that's helpful. And then maybe just one more for Sean. And so you'll be leading this integration here and a couple months ago we thought you were retiring, so just curious how long you're committed. Are you committed for the three or four-year period to kind of see this through completion?

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

Yeah, we haven't specifically talked about commitment, but I'm in it to get this job done, Kelly.

Kelly Ann Bania
Analyst, BMO Capital Markets (United States)

Q

Okay, thank you.

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

You bet.

Operator: Your next question comes from the line of Paul Trussell of Deutsche Bank. Please go ahead. Your line is open.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

Good afternoon. Just when we look at year one, could you talk about the synergy breakdown between overhead and operational cost savings? And how should we think about year one CapEx, and just overall, if you can talk about your philosophy around cash and investing, making capital investments versus paying down debt? And ultimately, what's the timeline to get to that leverage target of 2x to 2.5x?

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

Yeah, let me take the first part of that question, if I may. So, when we're talking about year one, think about when we kind of think about this way is quick wins. And I actually unpacked one earlier around indirect spend. When we have all of these – we have a significant addressable spend, $0.5 billion in addressable spend, that in aggregation with SUPERVALU delivers a lot of strength in terms of negotiation with goods, services, et cetera. And you're talking about an impact that has nothing to do with customer-facing transactions, it's something that happens in the background and can be delivered early. And it's that type of a synergy that lines up in our year one bucket. Some of the other synergies around optimization of a distribution center network, efficiencies around streamlining technology systems, those obviously have a longer lead time, and would generally be looking at year two, year three and beyond.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, and Paul, to your other question about CapEx spend and leverage, let me make a few comments. So, first of all, in our UNFI guidance, we talked about spending 1.5% to 1.7% of sales, and that's really driven by some capacity expansion projects that we feel very good about with or without the SUPERVALU acquisition. So we'll continue with those.

Generally speaking, we will look at investments on a risk-adjusted return basis and go after the best opportunities first. And this is part of our integration planning, it's part of the work streams, it's part of making sure we get to the biggest synergy buckets first. And the business has the ability to spin off a lot of free cash flow. I can speak for the management team here. We are a team that is comfortable operating at low leverage. We just completed fiscal 2018 with leverage of 1.15 times. Our long-term target, as you pointed out, is it 2.0x to 2.5x.

And so as we come out of the gates with SUPERVALU, we talked about our leverage at 4.7x, and we're very interested in getting that done. And that's the discipline that we'll talk about in getting back to the area we're more comfortable with. And as a result, we will forgo near-term M&A opportunities, we will forgo share repurchase in order to prioritize paying down the debt to get after our leverage target. We don't offer a dividend, we wouldn't start that up. And this is to get after that leverage. And so we'll work that down and we'll try to get that down into that target leverage range as quick as possible. But it won't come in the first couple of years. It will take us a little longer to get there.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

Appreciate the color. And just to circle back to gross margin, and I apologize if I missed it, but did you specify or quantify how much of the contraction year-over-year was related to the shift in customer mix versus what was the impact from the inbound freight costs?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, that's a good question, Paul. Think about it this way. Think about for the Q4 impact, two-thirds of it, customer mix, and a third of it the inbound freight headwind.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

Got it, that's helpful. Thank you and best of luck.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Thank you.

Operator: Your next question comes from the line of Vincent Sinisi of Morgan Stanley. Please go ahead. Your line is open.

Vincent J. Sinisi
Analyst, Morgan Stanley & Co. LLC

Q

Hey, great. Good evening, guys. Thanks very much for taking my question. Wanted to ask, I know you said, obviously, in the process of kind of over the next few months seeing about the consolidation of the distribution, but just wondering if you could provide any additional thoughts of, is it where two are located closely with one another, you just have to make sure you don't close obviously too much to turn in – excuse me, to capacity constraints? Or between the two companies, given the mix differences, is there a meaningful difference in the facilities themselves? I guess, said another way, whatever you ultimately end up doing, do you think there will be a meaningful amount of capital that will have to be put into the facilities themselves?

Sean F. Griffin
Chief Operating Officer, United Natural Foods, Inc.

A

Yeah, hi, Vincent, this is Sean. So, first of all, I really don't want to go any further as it relates to identifying any region or geography around optimization, I don't think that's fair and I don't want to get into that. As it relates to the distribution centers themselves and the characteristics, if you will, of the distribution centers, well, we certainly know that SUPERVALU's business model is quite different than UNFI and their portfolio is quite different than UNFI, but the actual four walls of the warehouses themselves resemble each other. They're multi-temp. These products, if we think about a distribution center, and frankly, this is the way we're thinking about it, are mixing centers. And what product itself that sits in that distribution center, whether it's a conventional food product or an organic food product, assuring that the handling protocols are appropriate, it's a mixing center.

So the utilization of the existing footprint of distribution centers will play to a benefit in terms of our long-term strategy. It will not be a hindrance. And we don't expect that there are significant capital expenditures related to any kind of retrofitting type of necessity, if you will.

Vincent J. Sinisi
Analyst, Morgan Stanley & Co. LLC

Q

Okay, all right, that's helpful. And then just as a quick follow-up, with the retail banners that are left, that of course, as you mentioned, not the main focus, we'll divest them, but maybe just looking back at some of the banners that have already been divested, what's been the success rate or how much of those sales have been retained to still be customers of yours and is that a focus of the ones that are still to be divested?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, so I think, if I understand your question correctly, how important is maintaining a supply agreement with the potential buyer. And that, again, is going to be very different by banner. So, in the locations where we desperately need the capacity, we will be more willing to separate the supply agreement from the sale of the asset. In the locations where we don't necessarily need the capacity, or in locations where it makes sense, then we would be more disciplined around making sure that a supply agreement is attached to the sale. But I would tell you based upon my certainly initial view, we're going to have a great deal of success here. There's a lot of demand for the services that SUPERVALU and UNFI provide. We know the markets where we need the capacity and we're willing to separate the supply agreements, and we've done a fair amount of work here, and SUPERVALU continues to do incredible work here. So to a large degree, my hat is off to them for leading the way as we get close to the close. But, again, I have a great deal of confidence that we're going to end up in a good place.

Vincent J. Sinisi
Analyst, Morgan Stanley & Co. LLC

Q

Fair enough, Steve. Thanks, guys. Good luck.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Thank you.

Operator: Your next question comes from the line of Rupesh Parikh of Oppenheimer. Please go ahead. Your line is open.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Good evening, and thanks for taking my questions. So first, on the supernatural growth that again accelerated this quarter, is there any more color you can provide in terms of what the contributions from new categories versus comp growth or just anything to help us think about that growth rate?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, I mean, again, Rupesh, we talked about lapping some of the new category growth and that's embedded in our guidance for next year. So, that's probably a pretty good proxy for what the number looks like.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Okay, great. And then, Mike, on EBITDA margins, there's been a number of questions on gross margins, and so I'm just curious, as you – the comment was that you expect moderating EBITDA margin declines, I believe, for this upcoming fiscal year. So I was just curious if you can help us at a high-level, understand the different puts and takes that help to drive that improvement, and also, wondering whether the accounting change has any impact on next year's margin performance.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, Rupesh, let me break it down a little bit for you there. So, we talked about customer mix, made comments about how that looks a little bit going forward. We talked about inbound freight, and that headwind actually dissipates and turns into increased product costs, which actually helps grow our dollars. And so that turns into a favorable – I mean, barring any additional freight increases, it does.

On the OpEx side, we've had some inefficiencies, Steve referenced it, with respect to labor at our DCs, and we would anticipate improving upon performance versus fiscal 2018 in that regard.

And then, another part of your question was on the change in estimate. And let me just spend a little bit of time on that one. Simply put, the change in estimate that we recorded in Q3 did not have a material impact on our Q4 results. Now, it's important to understand that that $20.9 million impact was contained in fiscal 2018 within the fiscal year, and specifically, within Q1, Q2, and Q3. And so, the year-to-date gross margin through Q3 captured the impact.

As we look forward, all else being equal, the change in estimate has no ongoing impact to our results. However, as you compare the fiscal 2019 results in Q1, Q2, and Q3 to our fiscal 2018 results, so the year-over-year impact, you will see an impact. And more specifically, we would expect a small year-over-year tailwind to COGS in Q1 of fiscal 2019, a larger year-over-year tailwind in Q2 of fiscal 2019, and then a larger yet year-over-year headwind in Q3 of fiscal 2019. So it's really that comparison back to prior year, because the impact of the $20.9 million was not spread evenly from Q1 to Q3, but was more heavily weighted towards Q3 when the change in estimate was booked in Q3.

I'd also say, if you want additional information, I'd refer you to our investor website. On June 19, we posted a presentation there, and on slide 19 of that presentation, you can see more detail and perspective on the impact of the change in estimate.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Okay, great. And then if I could slip in one more question. So the higher cost synergy targets, what buckets, or I guess, if you can give more color in terms of what's driving those higher estimates?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

More visibility. Confirmatory visibility.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Okay, great, thank you.

Operator: Your next question comes from the line of Bill Kirk of RBC Capital Markets. Please go ahead. Your line is open.

William Kirk
Analyst, RBC Capital Markets LLC

Q

Hi, thank you for taking the question. I guess, this one is for Mike. If I understand it right, the adjusted pro forma EBITDA guidance of $655 million to $675 million does not include what would have been a positive contribution from SUPERVALU's retail division, is that correct?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, so there are – as you know, their numbers, there's a variety of puts and takes with respect to their EBITDA. So, just covering them more broadly, as you go from the fiscal 2018 adjusted EBITDA from UNFI and SUPERVALU and you put them together, you've got some tailwinds in that you have growth in EBITDA from both UNFI and SUPERVALU, you've got the full-year impact of AG Florida and Unified Grocers and the related synergies, and then you've got the deal synergies that we would also expect in year one. And then, in terms of the headwinds that you have to adjust for, you've got the winding-down of the Albertsons TSA agreement, you've got the new expenses related to their more recent sale leaseback projects and some of the stranded retail costs as a result of divestitures. And then there are also the potential for other adjustments depending on how we account for things like post-employment benefits related to pension.

William Kirk
Analyst, RBC Capital Markets LLC

Q

Okay, so in the $655 million to $675 million, there's no expectation of profitability at SUPERVALU retail, there's no EBITDA from SUPERVALU retail in that number?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

That's ex-retail and ex-discontinued operations.

William Kirk
Analyst, RBC Capital Markets LLC

Q

Okay, got it. And then, so does that mean that the adjusted EPS accretion, does that exclude what would have probably been a negative EBIT contribution from SUPERVALU retail, because they were losing money on an EBIT level? So does the accretion exclude that negative impact to SUPERVALU retail?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

It is excluding retail and discontinued operations. And without getting into the details of the accounting, when the retail banners get moved into discontinued operations, there is an impact on the underlying wholesale business profitability. And then when and if the retail banners are sold, there's another impact to the underlying wholesale business. So we've tried to account for that. And when we say excluding the impact of retail, we're taking the wholesale business as it stands and making adjustments that I referenced.

William Kirk
Analyst, RBC Capital Markets LLC

Q

Okay, thank you. And then one more on the pro forma leverage, the 4.7x, in that calculation, does that include SUPERVALU's multi-employer pension responsibilities that were off balance sheet for them?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, the 4.7x includes everything. And, again, I would refer you to slide 13 of the deck where we give you the calculation of the 4.7x.

William Kirk
Analyst, RBC Capital Markets LLC

Q

Okay, thank you.

Operator: Your next question comes from the line of Marisa Sullivan of Bank of America Merrill Lynch. Please go ahead, your line is open.

Marisa Sullivan
Analyst, Bank of America Merrill Lynch

Q

Hi, good evening. Thanks for taking my question. I had a – I think that the – you expect the acquisition to close at the end of this calendar year, so kind of midway through fiscal 2019. How should we think about the accretion or dilution in, let's call it, year zero if year one starts in fiscal 2020? I mean, is that the right way to think about year one being fiscal 2020?

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, Marisa, let me take that. So what we've said is we expect the deal to close in the fourth quarter of this calendar year. And what we provided, in terms of guidance, was our year one assumptions. So that – so I think to your point, that splits the fiscal year. And so it really depends in terms of year one or the fiscal year or the stub year guidance, it really depends on when the deal closes. And so, that's one of the reasons why we're going to come back and talk more about it in January in Orlando, because we expect that the deal will have closed by then, and then we will be able to talk more specifically about the impact in fiscal year because we will know when the starting point was.

Marisa Sullivan
Analyst, Bank of America Merrill Lynch

Q

Got it. That's helpful. And then if I could kind of switch gears to the question of freight. You're good way through your fiscal first quarter, have you guys seen inbound freight headwinds consistent with where they were in the first – fourth quarter? Have they been increasing, just any kind of further color there would be helpful.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah, we've seen the inbound freight headwinds dissipate as we've started out fiscal 2019.

Marisa Sullivan
Analyst, Bank of America Merrill Lynch

Q

Got it. Thank you very much.

Operator: Your next question comes from the line of Ben Bienvenu of Stephens. Please go ahead, your line is open.

Daniel Imbro
Analyst, Stephens, Inc.

Q

Hey, thanks, guys. This is actually Daniel Imbro on for Ben. Thanks for taking our questions. Just to follow up on that last question on freight costs and growth margins, I think you've said you've seen the pressures dissipate. So, is it right to assume that your guidance includes an expected dissipation in pressure, or that pressure remains at similar levels?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, Daniel, let me take that one. So, barring any additional increases in freight costs, we would expect that the current freight costs, particularly the ones that we had through Q3, where we adjusted our inbound freight rates and our suppliers have certainly experienced the cost and we have incurred it as a result, so those get built in to our product cost. And, we're a company that likes inflation, and we like inflation because our contracts are predominantly cost plus a percentage markup. And so, this inbound freight headwind acts a lot like inflation, which is helpful to us once it gets built in to our cost of goods. And our issue has been that there's a lag in that getting built in, of one to two quarters. So that has been a significant headwind for us, but the short answer to your question is, we do expect that to dissipate and actually become favorable to our EBITDA dollar growth in fiscal 2019, again, barring any additional increases beyond where we're at.

Daniel Imbro
Analyst, Stephens, Inc.

Q

Okay, great. Thanks for the color, and actually it dovetails well into my next question, if we can exclude that impact from fuel, can you maybe give some high-level color on what your inflationary expectations are? I mean, we've seen PPI inflation for consumer foods kind of roll over here recently. What are you expecting for the full year with inflation?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, that's a good question. As I mentioned, we've had a couple of years now where we really haven't seen inflation anywhere near our historic levels. We've seen the reports that you've seen, in terms of inflation starting to come to some of the suppliers. But as we showed you in our Q4 results, it hasn't translated through to us yet. Our inflation is up a little bit, but certainly not anywhere near historic levels. We don't think that systemically that there's a reason why inflation will remain low over the long-term, but we also didn't build in expectation in fiscal 2019 of inflation going back to historical levels.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

We'd love to have it if it comes.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

A

Yeah.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.
A

For sure.

Daniel Imbro
Analyst, Stephens, Inc.
Q

Okay, great. And then, last one from me if I could, just on SUPERVALU, I appreciate that you're going to share more details around the revenue synergies at the Investor Day, but it sounds like you guys have mentioned pretty significant revenue opportunities between SKUs and different services that SUPERVALU offers. So high-level, can you just help frame up the size of that opportunity? I mean, do you think it's as large as the cost energy opportunity? Is it de minimis or somewhere in between? If you could just help us think about that opportunity at a higher level, that'd be great.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.
A

Yeah, I think it would be really premature for us to get into that, because we just can't do it until after we close, and we're really focused right now on the $175 million worth of purely cost synergies. But, to the point that we've been trying to make, and I'm very happy that you brought it up, we think that there are significant growth opportunities. But until we close, we just really can't get into that. We'll just going to have to wait until we meet in January. We're playing a long game [ph] on the program (01:39:48).

Daniel Imbro
Analyst, Stephens, Inc.
Q

Okay. Fair enough, guys. Thanks.

Operator: Your next question comes from the line of Eric Larson of Buckingham Research. Please go ahead. Your line is open.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Yeah, good afternoon, everybody. Thanks for taking my question. Mine are actually pretty quick. So in the $95 million and $100 million – in the $110 million of costs that you're going to incur for the next two years, is that all cash costs, are there any non-cash charges in there? Is that a cash number or is that only a partial, will only be partially cash?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.
A

Eric, it's a good question. It's primarily cash. We're talking about higher transaction fees, integration expenses, severance, retention bonuses, these kinds of things.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Okay. So will SUPERVALU – and obviously, we don't have all those detail – will SUPERVALU be able to generate enough free cash to cover that or will it eat into kind of legacy UNFI? I mean, how would you look at the cash cadence on that?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, once the deal closes and we're a combined company, we're financing it as a combined company and the debt that we bring on will be over both companies and we believe that there's significant ability to generate free cash flow to cover the expenses that we're anticipating here. And in particular, as you move forward and realize more and more of the synergies, that certainly benefits the free cash flow as well. And as we talked about in year one, we're talking about 25% of our run rate synergies and then it goes up from there which helps us finance some of the investments that we've got.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Q

Okay. And then just one final question, and this might just be a clarification. It gets back to your leverage ratio. I think it is in your prepared comments, Mike, you said that you have a goal of taking up around two turns of leverage off, I believe after the first two years, I believe. And, again, I'm not sure if that was adjusted for synergies, maybe synergies for SVU and maybe not included United Grocers or AG, I'm just not sure. But in your press release, you say that you plan to de-lever to approximately 3.2 times by the end of year three, so I'm just – I'm not – the numbers aren't kind of filtering – they're not adding to me. I'm not sure where – maybe I've got some numbers wrong.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, let me clarify that for you, and I think it's pretty straightforward, but let me give it to you. So, excluding the impact of the outgoing Albertsons TSA agreement, okay, so you know about the TSA agreement...

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Q

Yep.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

...and if you calculate our leverage and exclude that because we know that that's going away, that gets you to a higher number. And then you're two full turns down over three years is what we're talking here.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Q

Got it, okay.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

And that's how you get there.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Q

Okay, got it. Thank you.

Operator: Your last question comes from the line of Andrew Wolf of Loop Capital Markets. Please go ahead. Your line is open.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Thanks. I just want to comport my understanding on the quarter and the variance in gross margin to what you're saying. So my takeaway is that the miss was mainly versus your expectations in the inbound freight more so than the customer mix, and I just want to make sure I'm understanding that.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Andy, to clarify that, it's the other way. It's two-thirds of the gross margin miss is related to the customer mix and a third of it is related to the inbound freight headwind. Or in other words...

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

I'm asking about the miss, not the contraction. So I know the contraction was more from mix, but from what I'm hearing the miss versus your guidance was more from inbound freight. But maybe I'm missing, maybe I'm wrong...

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

No, no, no. I'll give you another perspective. So if you think about the leverage that we had in our consolidated operating expenses, that leverage virtually offset all of the customer mix dilution. Okay?

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Yeah.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

So to answer your question, then what would be remaining is the impact of the freight, which in this particular example is the driver of the challenges that we had in the fourth quarter.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Okay, thank you for that clarification. And I think you said it's – has it already reversed or is there more to come? I mean, again, I'm trying to get – are you already running up EBITDA? Because at first your guidance looks like a stretch, and then when you explain about the inbound freight and the big impact and the fact that it's going to come back so quick, I'm just trying to get a little more clarity.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

We talked about the fact that a lot of it was timing, and it just took one to two quarters of lag to push it through, [ph] we just have to wait (01:45:11).

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Yeah.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

What we specifically said is that we saw some general improvement in our freight so far this year. So that makes us feel better...

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Yeah.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

...that we're in a better position today than we were when we finished the fourth quarter.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

I guess a way to ask the guidance question that maybe you can answer is you're not just looking for a backend-loaded ramp in EBITDA growth, right? It may not be even each quarter, but it's going to be – it's not a just two down quarters and then two huge up quarters, it's going to be smoother than that, right?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, Andy, we would expect the year to be similar to the seasonality we've had in the past. So, yeah, we're not expecting a backend-loaded profit.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Great. And then I just – I mean, you've been asked this, but I just want to make sure I understand it, It sounds like the guidance expectations for inbound freight and fuel is roughly about flat with where it is now. Like, pricing, that's what you've baked in?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, yeah, we didn't – if the question is, were we assuming any increase or decrease in freight...

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Yes.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

...we were not.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

And fuel. Because I think you said that I just wanted to clarify that.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

And Mike, on – you gave a lot of leverage ratios and so on, but it sounds like you're not baking in any credit for proceeds that you're likely to get from retail, right? You're just penalizing yourself for the pro forma last business but not bringing down their leverage ratio, or are you? Just I didn't see that anywhere.

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

It's not a significant impact on our assumptions, no.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Got it. And just my last question on the low double-digit EPS accretion year one from the SUPERVALU transaction, that is essentially the synergies, right? I mean, if you're exiting the year at $45 million and some high proportion of that is realized, is that how to think about it?

Michael Paul Zechmeister
Chief Financial Officer, United Natural Foods, Inc.

A

There are puts and takes there, but certainly that gets you there as well, pretty close.

Andrew Wolf
Analyst, Loop Capital Markets LLC

Q

Got it, okay. Great, well thank you very much.

Operator: I would now like to turn the call back over to the presenters for closing remarks.

Steven L. Spinner
Chairman and Chief Executive Officer, United Natural Foods, Inc.

Thanks, everyone. We're really excited to lead the way forward at the SUPERVALU/UNFI combination, enhances our position with customers across many of our customer channels. We look forward to sharing more strategic and detailed information with you at our Investor Day in January. This is a big, exciting, industry-leading combination, and we are proud to be a part of it. We'll bring forth all the necessary resources from our board, to our leadership teams, managers, supervisors throughout the combined companies to maximize our success. Thank you for joining us this evening, and we look forward to seeing you in January.

Operator: This concludes today's conference call. You may now disconnect.