09-Mar-2022

United Natural Foods, Inc. (UNFI)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rob and I will be your conference operator today. At this time I would like to welcome everyone to the UNFI Fiscal 2022 Second Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. [Operator Instructions] . Thank you.

Steve Bloomquist, Vice President of Investor Relations, you may begin your conference.

Steven J. Bloomquist

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

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

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

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

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non-GAAP financial measures. Definitions and reconciliations to the most comparable GAAP financial measures are included in our press release.

I'll now turn the call over to Sandy.

J. Alexander M. Douglas

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

Thanks, Steve, and good morning, everyone, and thank you for joining us on our fiscal 2022 second quarter earnings call. As you saw in this morning's press release UNFI delivered the highest sales quarter in company history as we continue to build upon the key elements of our strategy.

Despite an environment that remains challenging, the six pillars of our Fuel the Future strategy all contributed to our results this quarter. At its core, Fuel the Future focuses on servicing customers and adding value to their businesses which leads to profitable growth for our company and increased value for UNFI shareholders.

We bring value to our customers in many ways and we're continually looking for the opportunities to do so. Consolidating purchases of natural, conventional, fresh, and specialty items with UNFI simplifies their business. Our own brands allow customers to offer a broad array of unique and innovative items that bring desired product attributes and affordability to their shoppers.

Professional services deliver solutions to our customers that solve a variety of needs and allowed them to take advantage of UNFI's scale to reduce cost for increased sales. And as consumers seek out healthier and fresher products, we're investing resources to drive growth across these categories. Chris will provide more details on each momentarily as well as the growth drivers of our retail stores.

The opportunity to add value also applies to what we can do to help our suppliers grow their businesses. After seven months and numerous conversations with CPG companies, I believe that we have significant opportunity to help our suppliers learn more about our diverse customer base and their many different go-to-market strategies and to tap in the knowledge that we possess from servicing 30,000 locations across all 50 states and Canada.

By providing insights not available through traditional sources we can assist suppliers in understanding the full opportunity in working with and through UNFI, which we believe will add growth and value to their businesses as well as those of our customers.

Our performance this quarter came during a time of heightened uncertainty across the economy. Continuing supply chain challenges are at the heart of the issues which continue to create short and long-term impacts on UNFI and our customers. Accelerating inflation along with varying degrees of negative unit elasticity, lower inbound fill rates, increased fuel expense, labor shortages, increasing wages, and increased use of third-party labor to manage stress points are all impacts on our business and our customers' businesses this past quarter.

The omicron variant led to significant numbers of associates not being able to work during periods of our second quarter. We proactively responded to the resulting higher associated absenteeisms with increased over-time and third-party labor investment to do the best job possible in servicing our customers.

Feedback over the important holiday selling period has been generally favorable as customers see how hard we're working to support them, but we know that we have significant opportunities for improvement and we're committed to continuously doing so.

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Moving on, UNFI's associates and the company's culture are what to make this a special place to work. I am proud we received a score of 100 on the Human Rights Campaign Foundation's 2022 Corporate Equality Index, the nation's foremost reported measuring policies and practices related to workplace equality.

We also plan to issue our 2021 ESG report later this month, again this year under the title Better for All. This year's report asked the question, can businesses create value for customers and shareholders and build something better for people and the planet at the same time? The report outlines the many steps that UNFI is taking to respond with our actions and our future plans. We've made progress in many important areas that benefit people, communities, and the planet while recognizing areas in which we can do better.

Overall, our strategic business decisions are guided by the pillars composing the Fuel the Future strategy but it's also important that they align with our Better for All goals. I would encourage you all to read about the strides we're making when the report is published later this month.

We're encouraged with the second quarter and our performance to-date in fiscal 2022. Our first half results and operating momentum position us to increase our outlook for full year sales and maintain the ranges for adjusted EBITDA and adjusted EPS, acknowledging that the environment remains volatile. Despite the challenges we faced in the first half of the fiscal 2022 our team's resilience, ingenuity, and agility give us confidence that we will deliver our updated outlook.

I want to reinforce that we will remain flexible to ensure that if conditions change, we'll take every action necessary as we did this past quarter to do the very best job possible for our customers. Looking forward, some elements of today's operating environment are structural and likely to remain while others will normalize over time. UNFI has a history of finding new ways to help customers and suppliers grow across our ecosystem while driving efficiencies throughout our business, and we expect that will continue in the years to come. We remain confident that we can and will deliver the fiscal 2024 financial targets provided at last June's Investor Day.

Finally, in recent months we've augmented our strong senior management team and our board talent with individuals who bring skills and experiences that will strengthen UNFI. To that end we're pleased to have added Shamim Mohammad to our board of directors. Shamim's proven track record and experience in technology and strategic leadership make him a valuable addition to our board.

In addition, I've recently added two seasoned executives to our leadership team who I'm confident will help us create value for our customers and help us execute on our Fuel the Future strategy.

So now let me turn the call over to our President, Chris Testa, for his remarks. Chris?

Christopher P. Testa

President, United Natural Foods, Inc.

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

Sales for the quarter were $7.4 billion, a 7.5% increase over last year's Q2 bringing that two-year stack to 14.6% and a 6% sequential increase over the year's first quarter. All sales channels experienced year-over-year growth while modest anticipated market contraction and continued deterioration in fill rates partially offset these gains. We're confident that our customer-centric approach is driving results and are pleased that the growth in the

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quarter came from both selling more to existing customers as well as from business we're now doing with new customers, each a key growth component in our Fuel the Future strategy.

Let's start with gains made with our existing customers. Looking at our top 25 customers and excluding the anchor customer and our new Allentown DC, revenue grew nearly 7% in the quarter compared to last year's second quarter and over 5% sequentially compared to Q1. A portion of these gains were the result of continued success with cross-selling as we added an incremental $100 million of total revenue in the quarter.

As customers consolidate their purchases with UNFI their operations become more efficient in multiple areas, including receiving, stocking, and back-office functions. Our year-to-date performance keeps us on pace to achieve $1 billion in cross-selling revenue by the end of fiscal 2022.

Our Fuel the Future strategy also looks to increase sales in our Fresh portfolio which includes meat, bakery, deli, and produce. We're pleased with the steady progress in growth we're seeing as we continue to invest in people, technology, and infrastructure to win in the important perimeter departments of the store.

Specifically in produce, our customers expect a high quality and view produce as the defining part for their store. We have expanded our direct-from-farm relationships, which improves our ability to deliver fresher product across a wide portfolio of conventional and organic offerings. Combined with the expertise of a merchandising specialist, I'm happy to report that our continued focus helped us grow second quarter produce sales at a rate that exceeded the broad US produce market by over 400 basis points.

Another differentiated benefit UNFI brings to its customers is its own brands portfolio. In the second quarter Woodstock, our 30-year beloved organic and non-GMO brand, grew over 17% with share gains in several natural channel categories including frozen fruit. We expanded own brand distribution with several larger customers in part due to our higher inbound fill rates that are consistently 500 to 1,000 basis points above national brands, in addition to gains resulting from joint business planning with our customers.

The final growth platform that I'll address is professional services where we continue to bring new ideas to our customers that provide value to their operations and growth for UNFI. Our services result yearly gains that were almost three times the growth rate of our wholesale business resulting from our focus of providing solutions for our customers beyond selling them groceries.

For example, our payments business added another 150 stores in the second quarter, which brings the total number of stores to about 3,500. Collectively these stores generate about 700 million transactions per year. And because of partnering with UNFI and leveraging our scale, we estimate their collective annual savings and processing fees to be about $40 million. That is meaningful savings to our customers that are trying to compete and find ways to improve their P&L especially in an inflationary environment.

As for new business, we're realizing sales gains across every channel from new business wins achieved last year in fiscal 2021 and over the last six months. Our sales pipeline remains robust and we continue to be confident in our ability to onboard new customers based on our unmatched capabilities to help our customers be successful.

Based on year-over-year unit sales increases we estimate that roughly 40% of our top line sales growth in the quarter came from volume gains including cross-selling and new business with the remainder coming from inflation.

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We're encouraged by the growth we're experiencing and the drivers behind the growth but we continue to be constrained by deteriorating fill rates caused primarily from upstream supply chain challenges. Deteriorating fill rates were driven by high demand the impact of omicron on the availability of freight and labor including in our own DCs as well as continuing raw materials and packaging shortages. Daily conversations with our suppliers reinforced the unpredictable nature of the environment as the recovery time lines generally are getting pushed further into the future, which will adversely impact the level of promotions and innovation launches this year.

Our merchandising teams continued to work on behalf of our customers to lessen to the extent we can the impact on their business. We're forecasting more frequently as supply challenges on one brand in the category can quickly cause demand spikes for similar brands. We're also making every effort to leverage our scale to maximize buying opportunities that include on demand ordering to absorb any excess inventory or assisting with our own transportation resources.

We are communicating regularly with customers to help find alternative products, including our own brands, so they can plan accordingly. UNFI's agility, resourcefulness, and persistence is helping us navigate the environment and we'll continue to do everything we can to help our customers.

Shifting to operations, although our second quarter operating expense rate declined 48 basis points sequentially from Q1 it was still higher than expected due to elevated absenteeism brought on by omicron. As Sandy mentioned, these unplanned absences led to greater reliance on overtime, third-party warehouse labor, and outside drivers to best service our customers during the critical holiday shopping season. It was further compounded by surging diesel prices which are up about 40% in January compared to January of 2021. Given the current state of global events, we anticipate fuel will continue to be a headwind for the near term.

With our distribution centers we continue to make meaningful progress on reducing the number of open positions. We finished the fiscal year 2021 with a DC vacancy rate of about 15%. The initiatives I spoke about on the last call reduced that figure to 12% at the end of Q1. Despite the onset of Omicron and the heightened absenteeism in December and January, we further reduced the vacancy rate to 9% at the end of the second quarter.

On the transportation side, the market for drivers remain highly competitive. We're taking meaningful actions with similar initiatives to address open driver positions and have stabilized the base. Our goal over the coming quarters is to make similar progress towards reducing our driver vacancy rate. We're still not where we need to be but the programs we've implemented to address worker concerns and lifestyle needs are clearly having a positive impact. They are also designed to increase associate retention which drives improved productivity and consistent performance for our customers.

Turning to our Retail stores, we're pleased with both the top and bottom line growth from our Cub and Shoppers banners. Last quarter I talked about bringing Cub's e-commerce platform in-house, which has delivered strong results. Average weekly e-commerce sales have increased about 25% and additional marketing and analytics capabilities are coming soon that will add to the brand experience for our customers. We've also seen great performance and community involvement from our pharmacies where scripts grew about 4% in the quarter, which is in addition to strong growth in seasonal flu vaccines and steady demand for COVID vaccines and booster shots in Q2.

We're also continue to invest in and optimize our Retail business as last month, Cub opened its 30th wine and spirits liquor store. Plans are already in place for the next store as we look to optimize and strengthen the Cub brand.

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As Sandy said, we're pleased with our performance this quarter and optimistic about the balance of fiscal 2022. We expect food at home sales to remain strong as people continue to work from home and manage their household budgets in the face of high levels of food inflation.

The environment remains unpredictable in several ways, but we're confident in our ability to help our customers succeed through all that UNFI has to offer. Let me now turn the call over to John.

John W. Howard

Chief Financial Officer, United Natural Foods, Inc.

Thank you, Chris, and good morning, everyone. On today's call I'll cover our second quarter financial performance, balance sheet, capital structure, and our fiscal 2022 outlook.

As Sandy said, second quarter sales of $7.4 billion was a new high for UNFI, surpassing the previous high in the third quarter of fiscal 2020 when the pandemic first began.

Second quarter gross margin rate increased 8 basis points compared to last year's second quarter. Our wholesale margin rate was again favorably impacted by our elevated level of cost inflation as our business model and customer contracts generally passed through product cost inflation which leads to both revenue and margin gains. The continued benefits from our transformational Value Path initiatives also contributed to our gross margin expansion in the quarter, which was partly offset by a higher non-cash LIFO charge.

Excluding a benefit related to an adjustment to prior [ph] MEPP (00:19:15) withdrawal charge estimates, second quarter operating expense rate increased 23 basis points. As Sandy and Chris discussed, this quarter's results included greater levels of overtime and third-party labor to service our customers as well as higher fuel costs. Last year's second quarter included lower health and welfare costs which amounted to about 17 basis points, and the cycling of that benefit was anticipated as part of our initial full-year outlook.

Adjusted EBITDA total $201 million which included a $19 million LIFO charge compared to a $7 million LIFO charge in Q2 of last year. Our GAAP earnings per share totaled $1.08 which included $0.05 in net charges. Adjusted EPS for the second quarter totaled $1.13 per share compared to $1.25 last year.

Turning to the balance sheet, we finished the quarter with total outstanding net debt of $2.42 billion, a nearly $70 million decrease compared to the first quarter. Our net debt to adjusted EBITDA leverage ratio improved sequentially from the first quarter at 3.1 times. As for the capital structure, we continue to proactively manage our outstanding debt including our maturity schedule. As you know, our $2.1 billion asset-based revolver matures in just over 18 months, and we'll plan to extend this maturity before it becomes current this October.

Also, let – remind you of the nature of our outstanding debt considering the Fed recent commentary on its intent to increase interest rates. Although our secured term loan and ABL both had variable rate structures tied to LIBOR, we have executed rate swaps that fixed the interest rate on over $1.2 billion of the approximately $1.8 billion in borrowings as of the end of the second quarter. We believe the modest amount of risk we do face from rising interest rates is manageable. Our latest 10-K stated that a 100-basis point increase in interest rates would add approximately $5 million to our annual interest expense, the equivalent of about $0.06 in EPS.

Let's turn to our outlook for fiscal 2022. Given our performance year-to-date, our momentum with new and existing customers, and our belief that inflation will remain at elevated levels, we're increasing our full-year expectations for net sales to a new range of $28.2 billion to $28.7 billion, a $400 million increase to the top and bottom end of the range.

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Due to the unpredictable operating environment and the potential for further operating investments to service our customers, we're not changing the ranges for adjusted EBITDA which remains at $760 million to $790 million, or for adjusted EPS which remains at $3.90 to $4.20 per share.

Our outlook for full-year capital spending has decreased by $50 million from $300 million to $250 million, driven by supply chain challenges we're encountering we are facing in terms of receiving materials and equipment as well as the labor necessary for installation. As a result, we're increasing our debt reduction expectation by the same $50 million to a new range of $150 million to $200 million, which includes the net proceeds from the Riverside purchase and sale-leaseback transaction that was completed in February.

Our third quarter GAAP results will include an estimated pre-tax gain of approximately $85 million, which equates to slightly more than $1 in after-tax EPS. This is now included in our updated GAAP guidance but is excluded when calculating adjusted EBITDA and adjusted EPS. With our higher full-year outlook for debt reduction we now expect our adjusted EBITDA net levered ratio to finish the year at approximately 2.7 times.

As you've heard, today's operating backdrop remains challenging and unpredictable, yet we remain confident in our ability to serve our customers and deliver on our updated outlook for the year. Before we open up the call for questions I want to reinforce the comment from both Sandy and Chris that UNFI will remain agile and focused on helping our customers succeed, which is core to who we are as a company. Importantly let me also reiterate our commitment to increasing shareholder value and delivering the long-term targets presented at June's Investor Day. We appreciate your continued confidence and support.

Operator, we're now ready to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of John Heinbockel from Guggenheim. Your line is open.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Hey, first guys, can you quantify a little bit and speak to the deterioration in fill rates? So what has been the magnitude of that? And do you think that we see a continued deterioration in the near term? And I guess other than flexing scale, is there anything else you can do to mitigate that?

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

A

Hey John, this is Chris. I'll start off with the answer on that one. So we saw improving fill rates right up until the end of the summer, right up until basically halfway through our fourth quarter last year, and it has deteriorated sequentially since then. We did not expect that. We definitely anticipated fill rates to improve.

The impact of it is really, really hard to measure on net sales. I'll put it to you this way. There is some cases where we're actually shipping more units of a particular SKU than last year but fill rate's been cut in half because demand is higher, and that's demand coming from new and existing customer base. So from a net sales impact,

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really tough to measure. I mean you saw the sales growth, over $500 million in the quarter, 7.5%. So we're still growing sales despite the fill rate.

Where it is impactful is the customer experience, and we're doing everything we can to mitigate that with our merchandising teams to replace items with products that are in stock including our own brands. And the second impact is on promotional dollars, although promotional dollars have increased year-over-year and it's behind where we thought that would be and that's because there's just not the supply to put those promotional dollars against.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Okay. Then maybe following up, right, if you have fill rates that are better than the industry, that would help you on the pipeline side, right, attracting new customers. But is there a reticence in your part to bring in a lot of new customers in a fill rate environment like this for fear of sort of executioner service not being where you would like it in the short run? Or no, that's – you think that's manageable?

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

A

Yeah, not at all. And what we're dealing with here is an industry-wide thing. So the advantage that we have is for many suppliers, we're a top five customer to them. So from an allocation standpoint, we tend to get a fair share – a lot of that allocated inventory. So no, it's an industry-wide event and it certainly does not at all prevent us from adding on new customers.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Okay, thank you.

Operator: Your next question comes from the line of Bill Kirk from MKM Partners. Your line is open.

Bill Kirk
Analyst, MKM Partners LLC

Q

Hey, good morning everybody. So Sandy, I think you called out the reliance on third-party labor in the quarter. From here, absenteeism is likely way down. I think Chris gave a stat on that. And then peak seasonality – peak demand seasonality is also behind. So I guess my question would be, with seasonality and absenteeism down, have you seen some cost improvements already in the first half of the third quarter here?

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

A

Well, obviously we'll talk about the third quarter when the third quarter is over on our call. But I think a couple of facts just to understand the second quarter is that about two-thirds of our year-over-year operating expense increase was a function of what we had to invest over the holidays in third-party labor and overtime. And we did that because strategically – and mission-focused on helping our customers. To the extent that we continue to make progress filling jobs which Chris outlined some of the numbers of our improvement there, and to the extent that absenteeism from COVID or any other cause continues to go down, you can expect that we would see that improve. And that's certainly what we're working to accomplish.

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Bill Kirk
Analyst, MKM Partners LLC

Q

Okay, perfect. And then how does cash use change with the new lower leverage expectation? I know it had been a goal to get under 3, and then your flexibility with cash opens up as you meet certain thresholds. So how does it change at 2.7?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, it's a great question, Bill. This is John. We always look at how to best utilize our cash to the benefit of our shareholders. Certainly, getting below 3 times opens up the ability for us to consider returns to the shareholders. That door I've said before, that door cracks open a little bit below 3, and it's kicked wide open when we get below 2.5. And then it just becomes – the returns to shareholders becomes one of many opportunities we have to use cash along with M&A opportunities, additional CapEx, automation, expansion, and as we optimize Retail. And we look at all of those opportunities within that portfolio to use our cash, and we'll continue to assess those as we move forward.

Bill Kirk
Analyst, MKM Partners LLC

Q

Awesome. Thank you, everyone.

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

A

Thanks, Bill.

Operator: Your next question comes from the line of Edward Kelly from Wells Fargo. Your line is open.

Q

Yeah. Hey guys, [ph] Anthony (00:29:59) on for Ed. Thanks for taking my question. I just wanted to ask about fuel prices. Can you just talk through how we should be thinking about higher fuel prices going through the financials? To what extent are there hedges in place? And what is baked in the customer contracts with surcharges? And then is there any lag for us to think about passing that through?

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

A

Hey, Anthony. So, our fuel prices as John mentioned are up 40% year-over-year for the second quarter, and we are anticipating that trend given what's going on in the world here to continue. We do have a program in place where we can hedge against certain inbound or outbound [ph] calling fuel (00:30:45) that has been in place and will continue to be in place, and then we have a fuel surcharge program with our customers that we pass through some of the increases but we recognize basically a four-week lag in doing so. So what we're seeing is that 40% increase and we're anticipating that that will continue.

Q

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Got it. That's helpful. And then just on Independents, it looks like there was pretty impressive growth in the segment in the quarter and I think in excess of 10% on a 3-year metric average basis I was just hoping if you can give us some little more color on what is driving that how much is Omicron play part in that acceleration versus what we saw in Q1 and how sustainable do think that is in the coming quarters?

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

A

You're talking about the revenue growth, Anthony?

Q

Yes, sir.

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

A

Yeah. So we'll start with the consumer. Certainly we're seeing food at home trends remain elevated. By most estimates it's around 52% of total food spend. That's above pre-COVID levels, and it seems to have plateaued there. In other words it remains really, really strong.

And you have a work from home dynamic going on where folks – it's been a fundamental shift that we believe it's going to continue. And now with inflation what the consumer is saying is that they are to spend less on discretionary categories and more on the essentials and of course that's good for the food category.

Regarding the revenue, it is strong because of that demand we're seeing from our existing customers as long – in addition to new business wins. And as I pointed out those new business wins are accounting for almost half of the revenue growth. If you look at the units, we estimate somewhere around 40% of the growth is coming from just pure shipping more units with the balance coming from inflationary lift.

Q

Got it. It's really helpful. Thanks, guys.

Operator: Your next question comes from the line of Eric Larson from Seaport Research Partners. Your line is open.

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Yeah. Thank you. Thanks for taking the question, everybody. So my question is on your revenue guidance, and I think, Chris, you may have touched base on this right now. So the increase in your revenue guidance, is this still kind – is it a 40/60 blend of unit growth versus inflation? Is that still kind of the mix for how your new guidance is looking?

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

A

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Hey, Eric. It's a good question. We don't split it out that way. We look at the revenue growth coming from not only the inflation but the sustainability of servicing the customers that we have today and the customer that we see in the pipeline.

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Okay. And so if you achieve your goal in fiscal 2022 of $1 billion of kind of new customer sales, what is that delta on a year-over-year basis? I know you had some big sales last year. What is incremental increase this is if you achieve that $1 billion of new customer revenue?

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

A

I'm sorry I can't quite understand the question.

Eric Larson
Analyst, Seaport Global Securities LLC

Q

So I think the $1 billion of new customer revenue is a cumulative number for the last year or two?

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

A

Oh, okay. You're talking about cross-selling? You're talking about cross-selling. You're talking about the cross-selling number that I referenced.

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Yeah, correct. Yeah, that's correct.

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

A

Okay, I'm sorry. I got confused with the new customers. So cross-selling is existing customers, right, primarily existing customers?

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Right, right.

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

A

So that's – yeah, yeah. Yeah. So that is in the year if you look at our guidance for the year we can attribute about a $1 billion we think we land about a $1 billion as a direct result of the aggregation and the combination of bringing together the two companies that wouldn't have existed otherwise. That's what that cross selling number is.

As far as going forward, we will continue to maintain that and add on to it with incremental cross-selling wins. So for example in the second quarter, we added $100 million of incremental cross-selling wins. But in aggregate, cross-selling will contribute about $1 billion for fiscal 2022.

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Eric Larson
Analyst, Seaport Global Securities LLC

Q

Okay.

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

A

Does that answer your question Eric?

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Yeah, yeah, it does. Thank you.

Operator: Your next question comes from the line of William Reuter from Bank of America. Your line is open.

William Michael Reuter
Analyst, BofA Securities, Inc.

Q

Hi, good morning. Just following up on one of the questions about your fuel and the ability to pass it through, you mentioned you passed through some of this on a four-week lag. Does when you say some is that the majority of those cost or is it some small component of those fuel costs?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, we passed through less than 50% of the costs. But what we're anticipating as we think about fuel cost and increases in the internal math that we've done. Even in the back half of the year, some of those increases that we're anticipating won't be dramatically material to our financial results between the hedging programs and the fuel surcharge that we're able to pass on.

William Michael Reuter
Analyst, BofA Securities, Inc.

Q

Okay, that's helpful. Is there any way to think about in general what your annual fuel costs were last year so we can get some context about the magnitude of what an increase represents?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, we haven't provided that information before so it's not something we would start providing now.

William Michael Reuter
Analyst, BofA Securities, Inc.

Q

Okay. And then my last question is with regard to the lower fill rates that you experienced. I expect the majority of customers are seeing this from a supplier, or they expect that they would see it if they had a supplier other than yourselves. Do you anticipate that this will have any impact in terms of customer retention? I would expect the answer is no.

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

A

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Yeah, the answer is no. I mean if our customer base – if they're buying from a wholesaler, there's a big benefit to buy from wholesaler with scale. And this is an area where scale is a benefit to help improve our ability and access to high demand items. So this is an industry dynamic, and in this industry dynamic you find that scale wins. In other words we have access to these high demand products because like I said earlier we're typically the top one, two, three, four, five customer for a lot of these suppliers.

William Michael Reuter
Analyst, BofA Securities, Inc.

Q

Make sense. I'll pass to others. Thank you.

Operator: [Operator Instructions] Your next question comes from the line of Kelly Bania from BMO. Your line is open.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

Hi, good morning. Thanks for taking our questions. Just wanted to ask about the market contraction that you were planning for this year, and particularly as you look at your volume trends across channels if you are seeing or expect to see any divergences in volume, by channel, or retailer type as customers react to these higher levels of inflation?

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

A

Hey, good morning, Kelly. This is Chris. I'll take that one. So I would call the market contraction about what we anticipated. And when I look at that, it's less than a per-unit basis and how many units were shipping but more unlike looking at share shifts that happening with the industry.

And we've seen some shift happening that seems to have plateaued. In other words it stopped and we've actually seen some share come back to our customers in the third period of the quarter.

So it seems to be stabilizing and look we have a strategy in place and it's always been our strategy in place to outpace the market contraction with cross-selling a new business wins in addition to developing customs programs by channel and we're committed to helping each channel maintain success.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

Okay. That's helpful. And another question on just the fill rates, just helpful commentary about the trends and the challenges there. But could that at all be of benefit to your cross selling initiatives as other suppliers deal with fill rates challenges? And does that maybe open up the doors for you in terms of cross selling and items that maybe you have better in stock?

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

A

Yeah it's a great question. The short answer is yes and I'll point to an example and that's our brands group. Our brands portfolio does over $1 billion at wholesale. In other words it's a very large portfolio and our fill rates and our brands are 500 to 1,000 bps better than the national brands. So when we anticipate or we see a long term out of

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stock SKU, we quickly try to pivot the customer to the SKU that is in higher in stock and in many cases that is our brands business.

So look it's a difficult environment and the winners in this environment are the ones that can navigate quickly and we have a sales team and a merchandising team and a procurement team that's doing that. We've had to change our behavior to be quick and nimble to secure high demand SKUs. And again this is where we're having a very big team that is in constant daily contact with suppliers helps a lot.

Kelly Bania
Analyst, BMO Capital Markets Corp.
Q

Okay. Thank you. And then maybe just the last one on Key Foods. Is there any color you can help us model with the contribution that was to the quarter? And is the timing of that ramping as expected and any startup costs we should be thinking about?

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

Yeah we're not going to talk about any specific customer or the margin or revenue associated with them, but we're happy with the Key Foods startup. We're happy with the Allentown distribution center that's just seven months into its start. We've onboarded a steady workforce there. We're making progress every day. And I will just tell you that Allentown DC has met our expectations.

Kelly Bania
Analyst, BMO Capital Markets Corp.
Q

Great. Thank you.

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

Sure.

Operator: And your last question comes from the line of Carla Casella from JPMorgan. Your line is open.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Hi. I have one follow-up on that prior question and [indiscernible] (00:41:50). So when you're selling more of your own brands versus branded is there significant margin differential around price point differential?

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

Hey Carla. This is Chris. Our brands business are margin accretive.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Okay it's fair. Okay great. And then I know you did an exit for some of your multi-employer pension. Is there any liability remaining and have you heard anything? Are your plans eligible for any of the ARTA assistance that we should be hearing about and may be your timing there?

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John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

Yeah, Carla. This is John. We are aware of that and we do have a team that monitors that and we do look for opportunities to capitalize on strategic plans to exit. We did that in Q4 of last year. We're monitoring the litigation and we continue to do so to look for those opportunities.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

Okay. Can you disclose the amount the multi-employer on balance sheet liability you would have as of this quarter or the next year?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

All right, no. I think we disclosed the appropriate amount in our 10-K, so nothing that we would disclose for the quarter.

Carla Casella
Analyst, JPMorgan Securities LLC
Q

[indiscernible] (00:43:09). Thank you.

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

Thank you Carla.

Operator: And there are no further questions at this time. I turn the call back over to UNFI management for some closing remarks.

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

I want to thank everybody for joining us this morning. I hope what you've heard and take away from today's call is that UNFI is growing and performing within a challenging environment by steadfastly focusing on the most important thing in our business which is our customers.

Our Fuel the Future strategy is driving our performance in many ways. Adding value to our customer's businesses remains at the heart of everything we do, and we're pleased with our performance while acknowledging that we can continue to get better in almost every facet of the business.

Our customers are the long and short term focus of our company and maintaining our flexibility to serve them in a challenging environment is a top priority. For our customers listening today, we thank you for your continued partnership and the business we do together. And for our supplies and UNFI associates listening today, my thanks to each of you for everything that you do for our business, our customers, our communities, and each other. And for our shareholders, thank you for the trust you put in us through your continued investment in UNFI. Thanks, everybody.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.

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