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United Natural Foods, Inc. (UNFI)

Wolfe Research Consumer Conference

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MANAGEMENT DISCUSSION SECTION

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

All right. Great. So, we have the United Natural Foods team with us here, the senior management. And just like fun fact, UNFI was the first company I ever picked up coverage of when I started in the business in the late 1990s. So, a much different company back then; it was a small, independent organic natural food distributor, and now it's grown into the goliath of the industry both in the conventional and in the organic natural segment.

So really well-positioned with that, and maybe guys – thanks for joining – maybe you can just kind of give us a quick update on the health of the grocery sector today.

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

Hey, Greg and [ph] Spencer (00:51), and thanks for having us with you this morning. I think the grocery industry is healthy now. It's clearly been through a lot. It continues to change. But sales are relatively strong. I think that maybe this slightly dark cloud in the middle of that is, is it's mostly inflation and unit velocity is weakening a little, so there's a need for the value chain to work together better to address unit velocity, but by and large, the industry is healthy and it's agile, and it's, given the diversity of brand positioning, doing pretty well.

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QUESTION AND ANSWER SECTION

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

Yeah. What's your thought in terms of same-store sales, but it really being driven by pricing in the industry? How sustainable is that and maybe also comment just because inflation came out, I don't know [ph] if you had a chance, I don't know if you've been in meetings (00:11) this morning, but if you had a chance to look at that, any thoughts on the inflation numbers?

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

A

Well, one thing we can definitely say is the economists are not getting it right. So you're not going to expect somebody with my training to get it right. I think to your first question, from my vantage point, anyway, units are a healthier measure of growth. And to the extent that unit softness exists, it's going to be important for brand companies, wholesalers and retailers to work together to address it. Consumption occasions is what this business is all about.

Now, having said that, you've got significant cost activity in everybody's business and that has to be recovered, whether it's manufacturers or passing it through the supply chain. But if I were to step way back, I would say that our focus right now in serving our retailers is to work hard with manufacturers, to try to get lots of lead time, to negotiate effectively, to manage down inflation wherever possible. But also to try to attract promotional spending to drive units above the trend, because that's the most healthy growth that we've achieved.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

So just to mention, like we did a polling question with investors and we just asked them about the consensus estimate for sales growth of 4.2% for fiscal 2023 and in July. And the answers are kind of all over the place, probably, more to a little bit on the conservative side or appropriate, so just wanted to mention that. And just kind of going back to some of the questions and you mentioned you talked about sort of pass-through prices by the manufacturers, so have you – like, when you talk to your CPG partners, well, from a natural or the conventional side, have they been more willing to provide increased promotions, trade spend, now that maybe fill rates are getting a little better and we can talk about the fill rates. But what are they talk – what are they saying in terms of – or what are you seeing from them in terms of passing through promotions [ph] and trade spend (02:39)?

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

A

Yeah. Greg, broadly speaking, I would say that we're seeing manufacturers get more constructive in terms of promotional spend, but it varies.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

Right.

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

A

Some of them are still pretty anchored in pricing and reducing promotional spend, but net-net average, it's increasing incrementally. And there's different kind of times when they expect to be accelerating more. We're getting a sense that the new calendar year maybe an inflection point, but as we mentioned when we're talking about inflation, this is really dynamic and one of the things that's important on our end is to buy right and to work well to attract the promotional activity. Secondly, it's important that manufacturers see what a wonderful brand building environment, the 32,000 retailers we serve is for their brands. I mean, these are rural outlets, they're urban outlets, [ph] they're ethnically positioning their value (03:44), they're premium, they're natural, they're conventional. And it's just a brand building heaven almost for manufacturers. And so, as we work with them, we're trying to give them that opportunity to activate into that environment, to attract their funding, whether it's promotional or consumer and shopper or digital ad spending. And all of that becomes part of what we hope to bring to our customers, which is advantage in a very dynamic environment. And the net net is, we see it incrementally getting better and we hear rumblings that it's going to get stronger in the months to come.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

Just remind me, do you – are Kroger and Albertsons customers of yours and it's – right now, it's in the press that potentially they're in talks to merge. I'm wondering how that would impact the industry as well as your company, if at all.

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

A

Greg, we wouldn't comment, obviously, on that kind of rumor. And frankly, my general policy is not to comment on the customer specifically at all. But more broadly, what I would say is, as I mentioned, we have 32,000 customers and they are some of the most dynamic, innovative, local and regional retailers, couple of national ones. And the one thing that's really great about our business is the generally robust and diverse customer base that we serve. And so, moves of that kind in the industry are not going to be significant to us if they do indeed happen.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

Okay. Talking about another big, big retailer in the industry, Walmart, so the industry has been given some breathing room as Walmart has faced headwinds on the general merchandise side of the business. And so, they're basically as you know, they're raising prices in grocery, how long do you think they'll continue to be rational with those price increases on the grocery side?

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

A

Yeah. I don't have any idea to be honest. The reality is that, Walmart is a great company. They're value-positioned. But there are a number of other value-positioned retailers in different verticals that are adjacent to [ph] food stores, as well as food stores (06:19). And I think value, whether it be the retailers positioning and we serve a lot of customers that are positioned as value retailers or categories and particularly private brand categories are going to be really strong right now...

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

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Right.

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

...if the consumer looks to stretch their food dollar, but value can be found relative to anything, a really good home meal replacement program by a food store can be competitive with food [ph] away from home (06:46). So the whole definition of how retailers play for value and what the strategy is from a brand category, service, location standpoint is all part of the mix.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC
Q

Yeah. And I don't know if you have a thought, but why do you think fill rates are still lagging pre-COVID levels, any sense of when those [indiscernible] (07:12)?

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

Yeah. That question is sort of like inflation question, although, we're a little more qualified to answer it. What we're seeing is a sequential slight improvement in fill rates, kind of gotten about 10% better over the last three to four periods, just kind of inching up. It's now becoming a category by category issue. The baby category, some of the wet pet food categories are still highly stressed. And the best that we can do in what we spend a great deal of our buyer and merchandising time with is to work with suppliers to take friction out so that they can get our retailers the maximum amount [indiscernible] (08:03) possible and at least to know in advance so that we can work substitution strategies and other strategies, but when does it all get better? I think, it incrementally gets better, but we see – some of the categories I just mentioned are the manufacturers are talking about 12-plus months [ph] out still (08:28) before they feel like they'll be sturdy again. So, I think, it's going to continue to be a case-by-case item and the premium will go to proactivity and agility and communication.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC
Q

Feel like the manufacturers have said, well, things will be fixed for the last like two years, but...

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

Yeah.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC
Q

Yeah.

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

Well – and to be on the one hand fair to them, I think, that's their intent. I think, the reality is that demand has been greater than supply [ph] and that's (09:12) not the worst problem in the world for a supplier. And so, it's incumbent on us to both through alternatives and substitutes and that's where our scale comes in, it helps because we can give options to our customers. And over time, the competitiveness and accelerated growth of

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private brands and the stability of the options should level things out a little bit. And at least [ph] if you get the (09:41) best that's possible [ph] out of everybody who is supplying that (09:45).

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

That makes a lot of sense. And one of the components in the whole entire supply chain is warehousing and trucking. So, how is that – look versus two months ago? How much has it improved? And if you look over the next few months, do you expect to see much additional improvement there?

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

A

Well, as we said on our call, the staffing levels have gotten sequentially better both in our DCs and across our driver force. That's great, because it allows us to drive the higher and higher and higher quality of on-time [ph] info (10:28) for our customers. Labor is obviously more expensive now. I don't expect that to go back, but the need to use third-party in urgent situations is diminished, because of the more stable workforce. We have a range of initiatives. This area our supply chain is probably the -it's the core functionality of our business and we have tremendous opportunities to return to standard operating procedure disciplines post-COVID to employ technology to improve accuracy and efficiency. And then, as you saw, we announced automation agreement with Symbotic to begin to take up what is already a reasonable automation platform and take it to the next level, so we can grow more efficiently. And I would say that we have a tremendous opportunity for improvement there. Some of it is environmental and some of it is simply our capability to use people, process and technology to get better.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Q

All right. Perfect. Thank you. Let me hand it over to [ph] Spencer (11:34). I know he has some questions as well.

Q

Thanks, Greg. And thank you, Sandy and John, for joining us today. Maybe if you could take a step back for a minute and if you think about the long-term investors in your business to truly believe – truly be an investor, you need to believe in the future of the independent grocer here. So maybe talk a little bit about how viable you think that segment of grocery is over the mid-term? And do you think the share gains that we've seen here are going to stick? Are we going to see any of these other players really be able to claw back some of those gains over the next few years?

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

A

So, first of all, I believe – and this is my business, so you'd expect me to say this, but I believe in the vibrancy and market position, competitive advantages of independents. And the reasons are, A, they're small and therefore they're connected to their customer. B, they control their labor force in a much more effective way than perhaps a big company would, because they know most of them. They know their customers, they're agile, what they don't have is scale and that's our job. Our job is to remove as much as possible the scale players advantage that comes purely from scale so that the agility and the innovation and the market positioning of the independent [indiscernible] (12:58).

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I think, McKinsey published an outlook that said that, independents would grow somewhere in the 4% range and we don't know any better than that, but that certainly jibes with the way we're seeing it and we – Progressive Grocer recently published a article where they said that, they listed 15 of the most innovative and agile independents in the United States and we're lucky enough to serve 13 of them. So I think, there is a strong outlook for them, if we do our job well and they are a great source of activation, a potential for suppliers and connecting all those dots is a lot of what we're focused on.

Q

That's helpful. And I guess, staying on that scale point, you recently given us some more details on the services side of the business. What can you do to accelerate the penetration of services amongst your independent and really improve that part of their business? And has there been any change since [indiscernible] (14:02)?

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

A

Yeah. Yeah. Thanks, [ph] Spencer (14:04). Look, I think we are a good wholesale distribution company and I think we can become increasingly effective and significantly more efficient one, which shareholders need and customers need. The place where we can game change is with services and services are effectively today everything that a retailer needs that we wouldn't deliver on one of our [ph] fleet trucks (14:36). So it could be assistance with credit card fees, in credit card services, it could be technology, it could be [ph] shelves set, it could be advertisers (14:44). You saw in our report at the first quarter we began to quantify what our brands program, our services program and our innovation program was as a percent of EBITDA. And we've talked before about the fact that we see outsized growth there. And the way I think about the company is, if we can improve our capabilities, so we attract more retailers and more categories over time, it is efficient and strong return way and then services becomes the activation point where we change the margin structure of our business and at the same time we are allowed to do that, because we're earning significant amounts of savings for our customers. And you can see that in our own brand portfolio that [indiscernible] (15:30) there and other sources of innovation, not the least of which is our services to suppliers. So, big, huge platform and a significant and rapidly growing in higher margin service platform alongside it.

Q

That's helpful. And then, if we roll back the clock to the [ph] SUPERVALU (15:53) deal, one of the ideas was to have one truck, one invoice for all your customers and to offer that. How [ph] close are you to (15:59) getting to that that point for your customers? And then, do you think that once you get there, there'll be an acceleration in cross-selling [indiscernible] (16:05) as you're better able to sort of sell those conventional to natural and vice versa?

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

A

Yeah, I think one of the things I'd say about cross-selling is the company has done very well with cross-selling, largely because it's extremely relevant. Natural retailers occasionally need conventional products and conventional retailers are [ph] on mass (16:25) wanting natural products. So the idea is [ph] right (16:30). Our system and process maturity is in progress. We're muscling through it today and it's not costing us sales. But the ultimate vision that you articulated of one truck, one invoice, common process, multi-echelon supply chain is a process that's going to take us a couple of years.

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Q

Got it. And then, maybe to shift to your guidance for a minute, you're not expecting to see a significant amount of margin expansion in this upcoming year, despite seeing pretty strong top-line growth. So maybe just walk us through why we aren't seeing more margin expansion there? And then, should we expect a bounce back in [indiscernible] (17:13) as you kind of make the investments now?

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

A

I'll let John comment on this as well. What I would say is that – and we said this in our call, but the majority of what we see in fiscal 2023 is the sales guidance we've given a very strong pipeline of potential new customers and categories. We're investing in capability around particularly our supply chain in our IT stack. And all of those investments have very strong returns. But some of those returns will come in future years. And I think we made those comments during our call. We have a tremendous amount of discipline around that set of investments and so clearly there's a expectation to get strong returns from those. And I think the last thing we said, and this was intentional as well is, we want to make sure that in the dynamic environment we're in, we are in a position to do whatever we need to do to respond to the market and so that those are the pieces that drove the value that we provided.

John, do you want to build, subtract, correct there?

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

A

No, you said it well, Sandy, I think. And that last part is really one of the key things that we focus on, it's ensuring we have the flexibility to serve our customers as we need to as we move through a relatively dynamic environment.

Q

Got it. And if we think about your business over the mid-term, how much you think is going to be [indiscernible] (18:50) growth? Do you think it is going to be driven by going deeper with some of your existing customers versus getting some new business wins like you had recently with [ph] Key Foods (18:55) and some of those big accounts?

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

A

Yeah. I think the answer is both. But I have a particular passion for expanding with existing customers for a couple of reasons. One, generally, the economics leverage the existing distribution, infrastructure, investment so that makes them marginally accretive. And secondly, it's a symptom of a healthy relationship. And third, there's a tremendous opportunity out there for us to sell new things to existing customers. Even some of our largest customers are telling us that as we continue to build capability in various categories that they'll look to us to expand their business relationship with us, because we give them really good value. And so, I think, you'll see both. But there's a [ph] particular – I have a particular energy for (19:49) expanding with existing customers. So all of that comes together in that $140 billion addressable market that I have in my first 14 months [ph] shifting (20:03) through quite carefully and I have confidence that it is at least [indiscernible] (20:05).

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Q

Yeah. Totally makes sense. And [indiscernible] (20:12) question, you said you're focused on units and driving [indiscernible] (20:14) that you guys helped to serve. But are you seeing your peers also focused on that and is that led to any increased price competition from whether [indiscernible] (20:29) as well?

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

A

Yeah. I would say that we operate in a very competitive industry. That hasn't changed. It's been that way. It is now. It will always be. And I think you have to talk to those companies about their strategies. I think in the end, the most significant driver of economics in our business is what our customers need to win and we have been able to find ways to manage that in a way that creates great value for them and allows them to win and we have to keep getting more efficient to continue to allow them to do that and to make sure we give our shareholders the kind of returns that would earn their future investment.

Q

Great. And then, maybe if we talk about supernatural business for a minute, [ph] would you talk about (21:23) how that channel or segment has evolved over the last few years and do you find yourself getting more categories in that segment?

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

A

Yeah. I mean, as you know that [ph] panel is a (21:36) category name for a customer, a single customer and I don't like talking about them either, but the reason is not because I don't love them, it's because it's their company and I prefer to let them talk about their own company. We're a service and supplier provider to them. What I will say, though is, in all transparency is, we did and have been expanding categories and our relationship is very, very good and we have very good personal and process relationships and we think the opportunity in supporting them is terrific.

Q

Totally fair enough. And then, maybe you could take a step back and you think about investing in the business, what areas do you think are going to have the biggest, biggest ROI are going to be the most impactful? And I think this year is one of the first times you guys have done zero-based budgeting as well. So what has been sort of the learnings or kind of the takeaways from that experience as well in the organization?

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

A

Sure. Look, I think, I'll give you four areas that I think are very high return and high opportunity areas. First and foremost is supply chain. Our roadmap of opportunity in supply chain is as long as you can imagine. There's simply a long history of unintegrated acquisitions. And buildings that are set up that reflect their history as opposed to how they could be reconfigured to optimize the supply chain, service quality and efficiency for our customers. And so, very big, very big opportunity in information technology and digital, both from a re-platforming as well as a customer experience perspective and further supplier experience so that they can activate and see

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the incredible brand building network that is our customer base. More tactically, I think, revenue management, which will come from that kind of data and really, it's not so much margin enhancement or margin enhancement sake, but it's simply getting really tight on the value proposition in the various segments and geographies and that's a significant opportunity for us as well. So – and then, finally, we're investing in our sales organization, in their skill set.

Salespeople, we have 800 to 1,000 of them. They're terrific. They have distinguished themselves over the last couple of years in incredible ways as human beings. We're going to simply invest and this isn't a huge investment, but it's a time and energy investment to give them the best sales and account management training that's available that I would have experienced in some of my [indiscernible] (24:35). And that simply helps them listen better to their customers and make sure we have a clear process and system around what the customer is saying so that our configuration can change in a more rapid and natural way.

Q

Well, I think we're out of time, Sandy and John, but thank you for joining us. Let me turn it back to you, Greg.

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

A

Thanks, [ph] Spencer (24:56).

Q

Greg, I think you're on mute.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

Thanks. Really appreciate the time. Sandy, John and Steve and I would say back when Whole Foods was publicly traded, UNFI was a was a great channel [ph] check and (25:11) so fun times. So thanks, guys. Really appreciate it.

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

Thank you, guys. Thanks for having us.

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

Thank you. Appreciate it. Thanks.

Gregory Robert Badishkanian
Analyst, Wolfe Research LLC

[indiscernible] (25:21).

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