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United Natural Foods, Inc. NYSE:UNFI

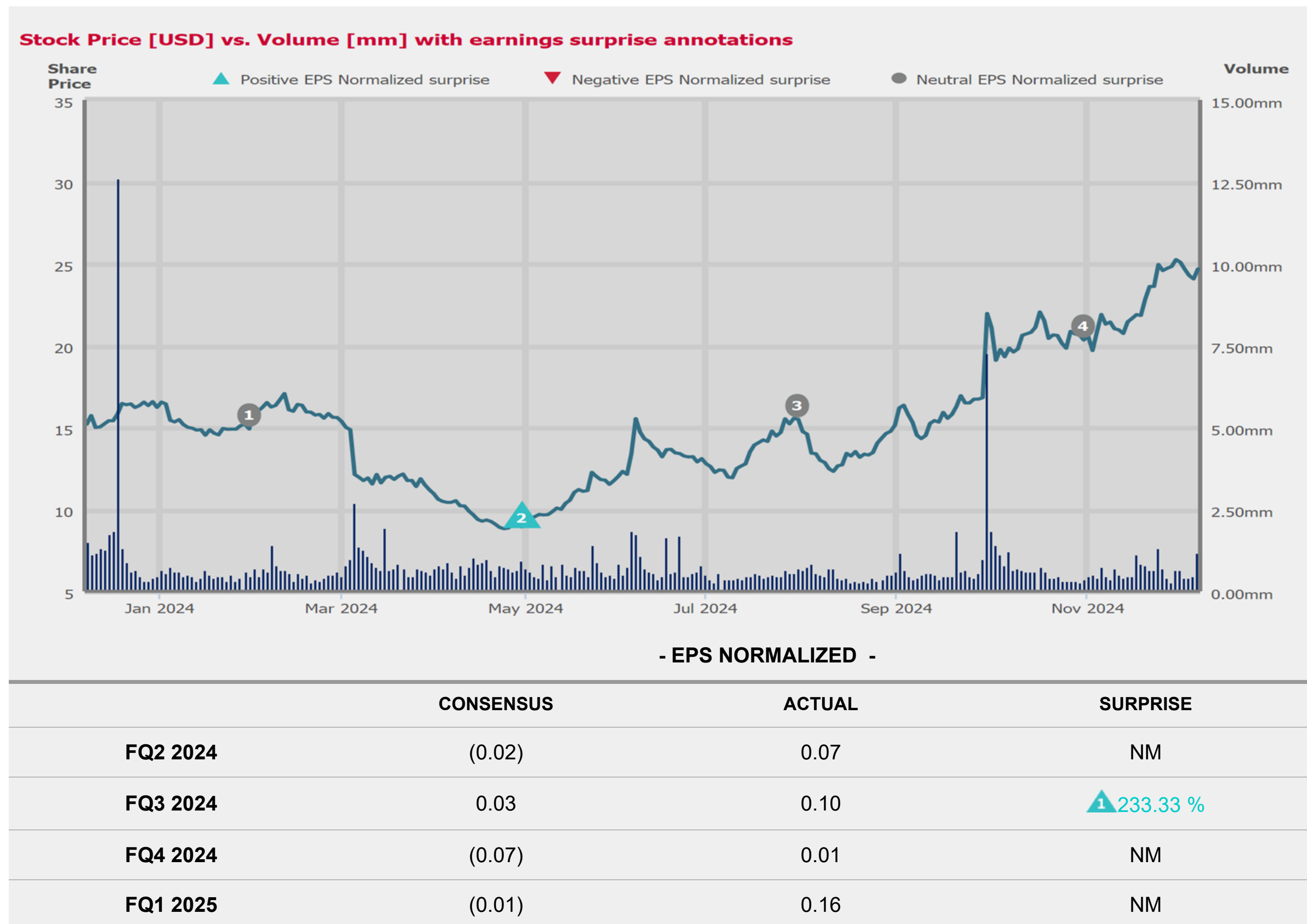
FQ1 2025 Earnings Call Transcripts

Tuesday, December 10, 2024 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2025-			-FQ2 2025-	-FY 2025-	-FY 2026-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.01)	0.16	NM	0.15	0.56	NA
Revenue (mm)	7612.19	7871.00	▲3.40	7844.25	30722.78	NA

Currency: USD
Consensus as of Dec-10-2024 1:20 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2024	(0.02)	0.07	NM
FQ3 2024	0.03	0.10	▲233.33 %
FQ4 2024	(0.07)	0.01	NM
FQ1 2025	(0.01)	0.16	NM

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Presentation

Operator

Hello, and welcome to UNFI Fiscal 2025 First Quarter Earnings Conference Call. Please note that this call is being recorded. [Operator Instructions]

I'd now like to turn the call over to Steve Bloomquist, Head of Investor Relations. You may begin.

Steven J. Bloomquist
Vice President Investor Relations

Good morning, everyone, and thank you for joining us on UNFI's first quarter fiscal 2025 earnings conference call. By now, you should have received a copy of the earnings release issued this morning. The press release and earnings presentation which management will speak to are available under the Investors section of the company's website at www.unfi.com. We've also included a supplemental disclosure file in Microsoft Excel with key financial information.

Joining me for today's call are Sandy Douglas, our Chief Executive Officer; and Matteo Tarditi, our President and Chief Financial Officer. Sandy and Matteo 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.

I'd like to point out that during today's call, management will refer to certain non-GAAP financial measures. Definitions and reconciliations to the most comparable GAAP measures are included in our press release and the end of our earnings presentation. And finally, beginning with the second quarter, we plan to change the sales channels reporting on the face of our press release. To assist with the transition, we will provide the new basis for presentation and historical figures prior to the next earnings call. We believe these changes will give you additional insight and transparency into our multiyear strategy and sales performance.

I'd now ask you to turn to Slide 6 of our presentation as I turn the call over to Sandy.

James Alexander Miller Douglas
CEO & Director

Thanks, Steve, and thank you, everyone, for joining us this morning. As we shared in our release, we delivered a solid start to fiscal 2025, which included revenue growth of over 4%, primarily resulting from positive volume growth in our wholesale business and improving adjusted EBITDA and free cash flow, driven by actions to enhance our capabilities and drive efficiencies across the business.

This performance led us to raise our full year outlook for all financial metrics other than capital spending. Based on the progress updates I'll share momentarily, we also remain confident in our strategy and multiyear plan and our ability to deliver the financial objectives outlined in our October call, which we believe will lead to sustainable shareholder value creation.

Now I'll go into more detail on the progress we made in the quarter, how it's helping the customer experience and how we're working to become a more efficient partner and value creator for our suppliers and customers. As we discussed on recent calls, we believe UNFI's scale, heritage and natural, organic and specialty products and our expanding value-added services offering makes us uniquely suited to help retailers differentiate and compete in a highly dynamic and competitive environment. We can see these points of differentiation supporting many of our customers as they successfully execute their strategies in the marketplace.

In the quarter, our customer base contributed to volume growth above the gains reported by Nielsen for the supermarket space and helped strengthen our top line performance and expected trajectory. Volume gains in the quarter were about 2% compared to the prior year, and we've seen this positive trend continue into Q2. Importantly, this performance indicates a solid start to the execution of our strategy, but it also demonstrates strong strategic execution by our over 30,000 store customer base, as we continue to sharpen our focus on providing differentiated products, programs, services and insights that help them compete effectively.

To help extend this performance, we remain focused on strengthening service levels, simplicity and transparency to our customers and suppliers while increasing efficiency across the business. We know how important it is to deliver on time and full in the important

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holiday selling season and the whole company is focused on it. We also continue to roll out our revamped go-to-market program for suppliers, which aims to streamline and simplify their experience and help them accelerate their growth within our diverse retailer network. Several of our large suppliers that have embraced the program have experienced volume gains that surpass their peer group as they've taken advantage of the data and insights we provide in areas such as new item placement or bringing items discontinued during COVID back on to customer sales.

We continue to focus on bringing additional suppliers into the program while making sure participants of all sizes have the best experience possible and are able to maximize the value and the growth opportunities that UNFI is making available to them. We will continue to execute our plan to pursue innovation in our offerings, optimize efficiency and strengthen service levels to help drive even greater value and trust with retailers as well as suppliers.

As we focus on becoming more efficient, Matteo's leadership has played a significant role in our progress. He has deep experience in helping turn around and improve businesses, largely through the disciplined implementation and rigorous follow-through of Lean Six Sigma management principles. This is already benefiting UNFI and our financial and operating performance. I'll let him provide more color and details momentarily, but let me talk at a high level about a few of the actions that we've taken to improve the overall customer and supplier experience while removing cost and streamlining the organization.

Reducing or eliminating waste is a big part of what we're trying to accomplish over the next 3 fiscal years. With shrink reduction a big focus over the past 5 quarters, we brought shrink in line with historic pre-COVID levels, and we're now working to reduce it further, while simultaneously striving to increase the capacity of our network through ensuring that we have the right assortment, which should help drive higher sales for us and for our customers.

Decentralizing responsibility and accountability in the organization is another principle of Lean, as is the mutual development of key performance indicators that get measured and course corrected in near real time. As Matteo described on our last call, we've begun the process of pushing the Lean framework into our distribution centers, where local operators are involved in the process of creating and taking ownership of operational KPIs. These same associates are at the center of problem-solving and creating action plans where performance is not meeting expectations. We piloted the process in 2 distribution centers and are pleased with the initial results. Next, we'll begin further aligning our organization to deploy this methodology across more of our facilities.

Our continued focus on network optimization has also proceeded as planned, and we have completed the closure of both our Billings and Bismarck conventional distribution centers, which we described last quarter. We have retained the vast majority of the business from these DCs, which is now being serviced from nearby, more modern UNFI facilities with larger assortments. We are now marketing the real estate.

For similar reasons, we made the decision to close our Fort Wayne, Indiana distribution center and transfer that volume to neighboring facilities in Pennsylvania and Illinois, where we expect customers to see assortment and service level benefits. Associates and customers were informed of this in mid-November, and we expect to complete this move early in calendar 2025. Fort Wayne is another owned DC, which will begin marketing at the appropriate time. We will continue to evaluate other similar optimization opportunities.

During the quarter, we also moved natural volumes from our York DC into our 50% larger, soon-to-be-automated Manchester DC, which we expect will yield service quality and efficiency benefits for our customers, suppliers and UNFI in the region. We can see the combination of adding value for customers and suppliers to support their sales alongside our efficiency focus, delivering tangible operating and financial improvement.

As we have combined above market sales volume with our improving efficiency, we've been able to increase net sales per employee by over 6% compared to the prior period, which is structurally improving profitability and free cash flow generation. This is partially a result of growing sales driven by the success of our customer base and expanding customer relationships as well as our actions to enhance the responsiveness of our organization and empowering associates deeper in the organization to make real-time improvements.

All in, we drove adjusted EBITDA growth of nearly 15% compared to the prior year first quarter and delivered our fifth consecutive quarter of sequentially improving adjusted EBITDA dollars. This progress reflects strong execution against our targets, and we will remain focused on executing at higher levels to continue to improve service levels, efficiency and free cash flow while reducing leverage.

As we execute, we become even more confident in our multiyear objectives, long-term trajectory and in our ability to add value for retailers and suppliers across the food retail ecosystem. We are focused on becoming the most efficient, value-creating long-term

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partner for our stakeholders, which in turn creates more opportunities for the approximately 28,000 UNFI associates who serve our customers with dedication every day. Together, we remain confident our plan will drive sustainable shareholder returns.

With that, let me turn it over to Matteo to discuss our Q1 results, Lean progress and revised outlook. Matteo?

Giorgio Tarditi
President & CFO

Thank you, Sandy, and good morning, everyone, and thanks again for joining our first quarter earnings call. As Sandy stated, we're off to a solid start in fiscal 2025 and remain confident in our multiyear strategy and the corresponding long-term financial objectives we outlined during our year-end call. Today I will provide additional insight into our first quarter results, including our free cash flow and capital structure, offer some early proof points around the initial success we've had with Lean principles and comment on our updated outlook for fiscal 2025. With that, let's dive into our Q1 results.

Turning to Slide 8. Our first quarter sales came in at $7.9 billion, 4.2% higher than last year's first quarter. In wholesale, volumes were up nearly 2%, which represented another quarter of sequential acceleration and continuation of the trends we experienced as we exited fiscal 2024. These volume increases reflected continued improvement across natural and conventional, with our natural business, again, seeing significantly stronger trends compared to the overall industry as well as expanded relationships with new and existing customers.

Inflation was largely unchanged sequentially at about 1%, and down approximately 2 percentage points compared to the prior year quarter. Total retail sales fell 3% year-over-year with ID sales down 1.4%, both lower declines compared to the fourth quarter of last year. This was partly the result of targeted promotional investments made to drive store traffic, which began partway through the quarter. Our team, in conjunction with the Cub franchisees continues to refine an operating plan expected to drive improving top and bottom line performance as we move further into the fiscal year.

Moving to Slide 9, let's review profitability drivers in the quarter. Our gross margin rate, excluding LIFO, was 13.3% of net sales in the first quarter, down about 40 basis points compared to last year, driven by both our wholesale and retail segments. Our wholesale margin rate declined approximately 40 basis points versus last year's Q1 due to changes in business mix at both the customer and the product level, lower procurement gains and ongoing strategic commercial investments. These were partially offset by progress driving innovation and efficiency, including through supplier programs and reduced shrink.

One driver of our shrink improvement this quarter was our work around eliminating waste, a key principle of Lean management. We've been successful in thoughtfully identifying and focusing our teams on several processes within our distribution centers where our expense ratio has creeped up following the period of COVID and broader supply chain challenges. Our actions have led to lower operating expense, increased capacity and more efficient workflows as well as reduced spoilage.

Retail gross margins were also below last year's Q1 levels, which, as I mentioned earlier, were driven by targeted price and promotional investments made to drive traffic, primarily at Cub. More than offsetting the decrease in gross margin rate was solid execution and management of our operating expenses, which, compared to last year, declined by approximately 65 basis points as a percentage of net sales.

As Sandy stated, we are focused on becoming a more efficient business that is better able to bring value and improving service levels to our customers and suppliers. This has led to consistent efficiency gains across our supply chain where we've generated sequential improvement in throughput for 3 consecutive quarters and a 5% improvement in cases per hour in Q1 compared to last year's quarter.

Adjusted EBITDA for the first quarter grew nearly 15% compared to prior year quarter to approximately $134 million. Absent the additional week in last year's fourth quarter, this was the fifth consecutive quarter of sequentially improving adjusted EBITDA dollars. This increased adjusted EBITDA during Q1 was complemented by lower-than-expected costs associated with our accounts receivable monetization facility as well as some investment gains. Together, this more than offset slightly higher amounts for depreciation and amortization and net interest expense. This led to adjusted EPS of $0.16 per share compared to a net loss of $0.04 per share in last year's first quarter.

Flipping to Slide 10. As I discussed on our last call, we are implementing Lean principles throughout our business and supply chain and are encouraged with the early operational improvement and financial results we have driven. One major undertaking that we have completed over the last few months is the decentralization of our procurement function. We've transitioned from having 1 centralized procurement team to a DC-based organization, bringing them closer to our customers and operations. This has empowered teams to be more directly involved in demand forecasting, allowing for more timely and accurate inventory ordering.

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While there have been some initial adjustments along the way, the team is embracing the process, learning and steadily driving improvement. We will continue to focus on driving sustained improvement in this area to help even better align demand with supply and to steadily increase customer service level, a core focus of our multiyear strategy.

The other initiative that I would highlight is the recently completed initial launch of Lean daily management routines and distribution centers in Texas and Colorado where measures of success were built around key performance indicators for safety, quality, delivery and cost, in that order of priority, all meant to create supply chain value for all UNFI stakeholders, including our suppliers and customers. Initial results showed an 11% improvement in fulfillment quality, 5% improvement in on-time delivery and gains in warehouse labor productivity. As we move through fiscal 2025, we plan to scale Lean daily management processes methodically throughout our network while sustaining our focus on quality and value delivery.

Turning to Slide 11. This emphasis on Lean principles helped drive profitability and free cash flow in the quarter. Free cash flow in Q1 was a use of about $159 million, roughly $170 million improvement over the past few fiscal years in which we used close to $330 million in the first quarter of each of these years. This improvement included paying an incremental $56 million of incentive compensation in the first quarter, which was not paid out in the prior year due to the fiscal 2023 performance.

Our first quarter progress were largely due to faster-than-anticipated progress on working capital management. This was partially driven through a shift in how and where we manage inventory. The decentralization of procurement with the inventory management closer to the end customers, which is particularly important as we focus on the Q2 holiday selling season and delivering strong service to our customers. Because a portion of the year-over-year favorability is timing related, we would not expect to see the same favorability to last year for each of the remaining 3 quarters of the fiscal year. Part of this is also driven by the nonlinear nature of the timing of the cash outflows for our supply chain and automation investments, which is captured in our updated full year outlook for free cash flow.

Our Q1 free cash flow was also reduced by nearly $70 million from the strategic decision to reduce the number of customers under our accounts receivable monetization program. As I suggested on our last call, this program was originally implemented to reduce our effective borrowing cost. However, the cost saving benefit no longer exist, and it makes it neutral from a cost of capital perspective relative to other funding sources. Although we plan to lower our usage rate of these and similar programs, UNFI retains the flexibility to strategically utilize additional capacity should we choose to do so in the future.

As is typical in Q1, our net debt levels increased sequentially and ended the quarter at $2.2 billion of net debt. This contributed to our net leverage increasing by about 0.2x of a turn to 4.2x, which is towards the lower range of the typical historical increase we have seen during our first quarter as we prepare for the holiday selling season. This performance in Q1 keeps us on track with our longer-term deleveraging goals.

Looking at Slide 12, fiscal 2025 is off to a solid start, and we're modestly raising our full year outlook for all financial metrics other than capital spending. As outlined in our press release, the updated guidance for net sales is a range of $30.6 billion to $31 billion, which represents a 1.3% full year increase at the midpoint compared to the fiscal 2024 when adjusting for the 53rd week last year. This represents about an 80 basis points increase in dollar terms from the midpoint of our prior outlook.

We have raised the bottom end of our expectations for adjusted EBITDA by $10 million, bringing the new range to $530 million to $580 million, which is a 9% increase over the last year at midpoint. In terms of cadence for the year, we expect first half adjusted EBITDA growth in the high single-digit to low double-digit range compared to the prior year period. This implies total adjusted EBITDA generation will likely be slightly back-half-weighted, reflecting the cadence of actions we're executing as part of our revised strategy and how this builds into results over the balance of the year.

Including the benefit of lower forecasted interest expense and a couple of small below-the-line items, our EPS and adjusted EPS ranges have increased as well with adjusted EPS now expected to fall within the range of $0.40 to $0.80 per share compared to $0.14 last year. Full year free cash flow is now expected to be more than $100 million, which compares to our prior outlook of approximately $100 million, and represents around $200 million in improved year-over-year free cash flow.

As Sandy mentioned, we have completed the closure of both our Billings and Bismarck distribution centers and retained the vast majority of the business, which is now being serviced out of nearby facilities. We're in the process of marketing the real estate underlying both properties, but we will not sacrifice value for time which is the same philosophy we will apply for the Fort Wayne closure and future sale. As I said in the last quarter, we will continue to evaluate other opportunities along these lines, but have not included any incremental strategic actions in our outlook.

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Flipping to Slide 13, we enter fiscal 2025 with a stronger foundation and operating momentum, which continued through the first quarter of the new year. Our efficiency initiatives, powered in part by Lean principles, are generating the operating benefits we expected while our volume trends reflect the successful execution of our customers as well as the trust they place in us every day.

Our strategy of bringing value to our customers and suppliers through a differentiated value proposition and strengthening service levels while improving UNFI free cash flow is simple and powerful, and we are executing against it. Sandy, myself and the entire leadership team remain confident and optimistic about our future and the value creation opportunity we have as we work to improve our capabilities and customer-facing execution. Our focus on delivering and deleveraging remains intact, and we look forward to updating you on our progress again next March.
With that, operator, please open the line for questions.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from John Heinbockel from Guggenheim Partners.

John Edward Heinbockel
Guggenheim Securities, LLC, Research Division

Sandy, I want to start with decentralized procurement. Maybe just talk about balancing, right, you want to manage the inventory locally, but you want to buy it with the benefit of scale. So how you're managing that?

And then when you think about accountability is great, but if you can write alter your or make the compensation program sort of -- kind of make changes there to strengthen accountability, what do you want to do on the compensation side that might be different?

James Alexander Miller Douglas
CEO & Director

John, as we said on the call, a key tenet of our strategy is adding value to our customers and suppliers. And a big part of that is having the products that they need delivered to their stores in a timely fashion. And overall, with those goals in place, we're focused on delivering strong customer fill rates, and we've set the goal of reducing our inventories back to pre-COVID levels within the scope of the multiyear plan.

We view this in some respects, like the shrink goal we've been pursuing over the past 5 quarters, and we see significant opportunities for improvement both in working capital and in service. Part of achieving better working capital efficiency, as you know, is moving the decision-making and the view closer to the store so that our associates can be involved in the forecasting and the analysis. And we expect the change to better serve customers and to be a more efficient partner. And we're always looking for ways to align compensation directly with the outcomes that we're seeking in the business.

I'd also say that this is early days in this process. We're continuing to refine the model to make sure that it delivers exactly as it's designed and it's consistent with the Lean principles that Matteo has brought to the company.

John Edward Heinbockel
Guggenheim Securities, LLC, Research Division

And maybe as a follow-up, I think you mentioned 5% improvement in cases per hour. I believe that was the number. Now you didn't give what the result was in the 2 DCs. So I'm curious, I mean, you should see improved productivity beyond that, right, as you roll out Lean. Is that fair? And when you think about time to -- we implement sort of day 1, when do you sort of hit your stride on focus on productivity? Is that -- is it 6 months out? Is it a year out? Is it longer? What's the timeline?

Giorgio Tarditi
President & CFO

John, it's Matteo. As we discussed in the last call, our goal is to target in between MSD and HSD productivity at our DCs, and that is through a combination of the Lean principles that we're deploying, as well as the benefits and the learning from the automation efforts. So it's a balance of the 2.

Specifically at the 2 distribution centers where we piloted Lean daily management with safety, quality, delivery, cost KPIs, we're seeing the 11% improvement in fulfillment quality, 5% improvement in on-time delivery and also some benefits from a productivity standpoint. But bear in mind that these are 6 to 8 weeks old initiatives, so there is a lot to ramp up there.

And the framework of 6 to 12 months between the deployment of Lean daily management to the other DCs and the learning and the ramping of the automation initiatives is the right framework, and that's how we're thinking extracting $150 million of cost from the roughly $4 billion of total costs from the business in the next 3 years.

Operator

Your next question comes from Leah Jordan from Goldman Sachs.

Leah Dianne Jordan

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Goldman Sachs Group, Inc., Research Division

Your updated sales guide implies a deceleration for the balance of the year on a comparable 52-week basis. Just if you could walk us through how you're thinking about inflation and volume as drivers for the balance of the year, underscoring that. Just surprised, given the new business wins this quarter, that you called out volumes coming in a bit better than expected. Why should that not flow through in a bigger way for the remainder of the year?

Giorgio Tarditi
President & CFO

Leah, thanks for the question. So in the first quarter, we saw volumes growing about 2% in wholesale, delivering total growth of 4.2%. And that was a trend that we picked up in fiscal [indiscernible], as you recall, and carried into the early innings of the second quarter. So we are thinking about the new guidance, which is now at midpoint, $30.8 billion rounding as basically a roughly 1% growth for the remaining 9 months of the year, that is balancing 3 dynamics.

One is the strength that we continue to see with our natural customers. Second is the more modest volume declines that we've seen in conventional. And then third, the ongoing dynamics with the DC optimization.

So as Sandy mentioned, we're able to retain the vast majority of our customers in Billings and Bismarck. We're now going to go through a similar experience with Fort Wayne. And we feel that the balance for the remaining 9 months is, again, embedding no risk and no dynamics, but also the strength that we see with the natural business. And again, the more modest declines that we are seeing in conventional. And we keep the overall commercial backdrop front and center as we think about the execution for the remaining 9 months.

Leah Dianne Jordan
Goldman Sachs Group, Inc., Research Division

And then just on a related follow-up, just digging a bit more to the new business gains this quarter driving some of that volume. Which categories are presenting the most opportunities for you now? And then why do you think these same customers, existing customers are more engaged now? Or how do you think you're resonating more today?

James Alexander Miller Douglas
CEO & Director

Leah, this is Sandy. I guess one of the things that's most interesting about the broader environment is how segmented and differentiated retailers are performing very, very well. I'll give you an example. Multicultural focused customers in many markets are materially outperforming the general market by their differentiated offer and the way they compete. And obviously, we're focused on providing great support for them as well.

You've seen the natural organic performance driving significant growth as well. And so as we think about the way we show up, is making sure that we have the product services and programs that retailers need to drive their strategy. And inside the shop, there's a lot of growth in fresh. There's -- we mentioned natural products and multicultural products. But we're also bringing professional and digital services that are helping customers compete as well.

Operator

Your next question comes from Andrew Wolf from CL King.

Andrew Paul Wolf
CL King & Associates, Inc., Research Division

I want to ask about the gross margin rate contraction in the quarter, and if you could give us any sense of the outlook there? At least sequentially versus the last couple of quarters, at the end of last year, last fiscal year, there was a pickup in that gross margin contraction. So you've talked about some of the sort of things that could contract it, let's say, our commercial investments, customer mix and things that were helping with shrink, and other things. Could you sort of just dive a little deeper into the quarter, why the contraction might have been greater than it was? Why it was greater than it has been? And what's the outlook to the extent you're willing to talk about that?

Giorgio Tarditi
President & CFO

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Andy, the gross margin rate in the first quarter at Slide 4 was 13.3% versus 13.7% in Q1 of last year and down about 20 basis points or so versus the fourth quarter. Now, notably, it grew $7 million and contributed to $7 million of the $17 million of EBITDA growth. And if you unpack the $7 million, we actually saw about $13 million of growth in wholesale and a decline related to volume in retail.

There are a lot of drivers that go into the gross margin rate, and we commented that the 2 key drivers were planned customer and product mix, which were partially offset by the improvement in shrink and supplier programs.

Also bear in mind that some of the large customer mix pressure has some offset in OpEx with fewer and lower drops as, again, we scale up our facilities.

I would highlight that the -- we continue to be very focused on improving the margin rate, including further shrink improvement. As Sandy mentioned, we're back to the pre-COVID levels, but we embrace Kaizen and continuous improvement there. We're focused on growing our professional and digital services business that clearly give us some additional calories on the gross margin, as well as private brands, and committed to grow both top and bottom line for retail.

We're also reworking and revamping our commercial screening process, as we commented in the last call. So within the $90 billion resilience space, we continue to look for opportunities to create and get recognition for value with customers and suppliers.

So we're very focused on the gross margin conversion and increase in the gross margin conversion as we see sales growing. On the other side, we're also pleased with the fact that we delivered substantial operating leverage with top line up 4%, operating expense has been down 65 basis points as a percentage of sales, all put into a 15% growth in EBITDA.

Andrew Paul Wolf
CL King & Associates, Inc., Research Division

Great. I appreciate that granularity. So it sounds like the gross margin rate contraction was much less so, obviously, in wholesale, even though -- I mean, it was more in line with the sales growth. And I think as you spoke to, there was some investment in retail, which I guess, to get the same-store sales improving. And that's why retail gross margin was down year-over-year, gross profit dollars?

James Alexander Miller Douglas
CEO & Director

I think that's right, Andy. This is Sandy. I would also point out that our retail business grew its EBITDA by $1 million versus prior year also. So it's a part of a rebuild and a strategy that our franchises are -- our franchise community in the Twin Cities is working with our retail leadership to galvanize the brand. And so we're investing some in price to be more competitive, but we're funding it through the operations. And we're, I would say, optimistic, but early days of the retail turnaround in the Twin Cities.

Andrew Paul Wolf
CL King & Associates, Inc., Research Division

And if I can ask a much longer focused kind of question, if I will. I think the Lean processes are -- sounds like they're gaining traction pretty rapidly in labor productivity and other efficiencies. But they're pretty new. So I think it's quite reasonable to assume that it's the rightsizing of headcount reduction and less facilities that really is driving the lower operating expenses as adjusted.

And what I really want to get to is, will that sort of mix change over time, when you start heading to the back end of -- the second half to the back end of the fiscal '27 guidance, is it going to be more of the Lean processes that really start to drive labor operating expense efficiencies, more so than I would imagine upfront?

James Alexander Miller Douglas
CEO & Director

Andy, let me do the first half of this and then I'll let Matteo dive into the way the Lean process works. But I would call out on our strategy 4 key components. The first is organic growth driven by a very resilient $90 billion segment of the industry, a segment where we're seeing retailers grow and a segment where we are designed as a company to serve in a differentiated way.

Secondly, the focus on value added to customers and to suppliers is a key component for how they compete and win, and we're designing products and services and programs to do just that. All of that creates the top line engine and then, clearly, efficiency is a huge component in a $30 billion company with our margins and with the strategy to grow our operating margin sequentially as a core part of value creation. It's going to be important that we're incredibly efficient. Our customers need us to be -- or suppliers do, and so do our shareholders.

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And then the final component, optimizing free cash flow is a critically important element as we deleverage the company back to lower levels that we committed to in the 3-year plan. And so I view it really capability-wise as sales and merchandising meeting lean management principles to drive a virtuous cycle. And Matteo, maybe lay out sort of the sequence for Lean as we go forward.

Giorgio Tarditi
President & CFO

Yes. Thank you, Sandy. We are really focused on 2 areas at the moment from a Lean standpoint. The first one is to deploy Lean daily management as a way to create quick problem-solving and countermeasures at the point of impact. That's why we selected 2 distribution centers to pilot. We have a few more implementing the Lean daily management, and we're also embracing it in the functions.

The second area is waste elimination, identifying nonvalue-added steps as a way to create capacity, build capabilities and build efficiencies. And that is a process that takes a lot of discipline and probably longer horizons. But we are very, very focused on applying this methodology as a way to create value and efficiency for our customers and suppliers while remargining UNFI and generating the free cash flow to get to 2.5x or less leverage by the end of 2027.

Operator

Your next question comes from Kelly Bania from BMO Capital Markets.

Benjamin Wood
BMO Capital Markets Equity Research

This is Ben Wood on for Kelly. I want to start with, first, how is the demand for your services tracking? And where are we in the evolution of some of those programs and offerings? Previously, UNFI had disclosed it was about 20% of EBITDA, which we believe may be a little closer to 30% plus given where EBITDA is expected now. Is that fair? And where do you see services growing at and mixing to longer-term?

James Alexander Miller Douglas
CEO & Director

Yes. I think we shared that number in beginning of fiscal '22. And at the time, we described services and brands as being a little bit more than 20% of our EBITDA. We've said in less specific ways over the last couple of years that they continue to outgrow the company, and that is certainly our strategy for those businesses.

And I put them into 3 buckets. There's the professional services that help retailers save money and run their stores, their digital stores that help them modernize their tech stack and begin to attract investment like the early days program we've built around the retail media network. And then Brands Plus is a broad strategy that we have to fit segmented brand portfolios to different retailers' brand sets. And a good example of that is our natural and organic portfolio, which is growing from mid- to -- mid-single to mid-double digits from a growth perspective.

So we still don't disclose the operating segment as a special segment, but it's a meaningful part of our profitability and even more meaningful part of our growth.

Benjamin Wood
BMO Capital Markets Equity Research

Great. And then kind of following up on your last point there, Sandy. With some of the success, and it seems pretty drastically different in kind of the natural and organic categories and channels, are you seeing more interest from other parts of your wholesale universe to kind of adopt some of those offerings and put them into their assortment? Are any of your customers trying to chase volume growth by adding more natural and organic categories?

James Alexander Miller Douglas
CEO & Director

I think it's broadly a consumer trend that better-for-you and healthier products are gaining traction, and we're certainly going to follow what our customers want to do from a product and merchandising standpoint. So I think your assumption is right.

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The interesting thing that I mentioned earlier, though, is that the whole proposition that the retailer brings is important to their winning. And being in our business, we're in the support business of customers, whatever they're positioning. And I do think the presumption of your question that natural, organic and specialty products are important is a good one. And certainly, we're seeing that.

Benjamin Wood
BMO Capital Markets Equity Research

Okay. And then just 1 quick follow-up, if I may here. Where are we in the rollout of the simplified fee structure? What proportion of your customers are on that? And what's some of the main pushback you're hearing to a faster adoption to that?

James Alexander Miller Douglas
CEO & Director

Yes. And I think what you're referring to is our supplier go-to-market program and simplified supplier approach. We're well into the rollout of that. The supplier go-to-market program is for large suppliers. It's a customized program. We're well into the second year of that.

And we've seen some really compelling results from suppliers who have been early adopters. The simplified supplier approach, which is for all of our suppliers, takes 15 to 20 fees and eliminate them and replaces them with a single subscription. And that one has been broadly adopted across the smaller suppliers.

I would say where are we in the maturation of the process, I'd answer it 2 ways. First is we're learning a lot, as our suppliers, and we're working hard to make the tools more accessible and easier. But I think in the process of the dialogue, we have learned that we have an opportunity more broadly to work on the supplier experience. And we have a whole-of-company effort, that Matteo and I review every week, to improve key aspects of the supplier experience to take friction out, to add transparency and to help our suppliers succeed with the program you asked about, but more broadly in our ecosystem.

Because it's important to our customers that we have the best brands and brands that are comfortable because they can see their business in our ecosystem and they can invest to grow. And so that's why it's such a big priority of ours to improve their experience.

Operator

Your next question comes from Alex Slagle from Jefferies.

Alexander Russell Slagle
Jefferies LLC, Research Division

Congrats. Actually, I just wanted to follow up on a couple of those points. And maybe just a bit more on the supplier go-to-market programs, and I think you provided some examples just how successful this has been for certain suppliers, which sounds pretty impactful, so curious on that. And then just sort of how that feeds into your business and profitability specifically.

James Alexander Miller Douglas
CEO & Director

Yes. I think I'll try to give you a couple of examples so that whether one would be a big supplier and one would be a smaller one. And obviously, I won't name the suppliers, that's up to them to do. But 1 very large supplier was part of the pilot, and they brought the strategic objective of trying to capture 35,000 unique SKU retail store distribution opportunities that had fallen off during the supply chain disruption during COVID. And we built an effort to build programming for our retailers that would create the opportunity for retailers to access those brands and get a launch program that the supplier had built.

And we got about 95% of the way to the goal, and it taught us what we could do in that area. And so that's now a part of some of the other customized programs, to help retailers make sure they've got the right products that they want to have, not just the ones they had when the ones they wanted to have ran out. And so that's been a big initiative there.

For smaller suppliers, I think the biggest tool we've given them is the ability to see their sales through our system into retail, which, with that data, they can then target their programming and work with our sales force to try to make sure that their brands are doing as well as possible, particularly in stores that are growing.

And so I would describe the whole thing as a learning process. Early days. The benefit to UNFI is we make slightly higher fees on the bigger suppliers, approximately the same on the medium. And then we still keep fees low, but it's 1 fee, not 15 to 20. So it allows

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suppliers to be able to plan and execute. And as I said earlier in my broader answer, we view the supplier experience as a strategic opportunity for improvement, and we're in very much the early innings. But we're taking action on a weekly basis to try to do it better.

Alexander Russell Slagle
Jefferies LLC, Research Division

That's helpful. And earlier, you mentioned natural and organic portfolio growth and sounded -- mentioned mid-double digits, maybe I got the number wrong, but if you could just clarify what you have commented.

James Alexander Miller Douglas
CEO & Director

Yes. And no, I said all of that, and it probably was confusing. I was thinking about the 3 platforms within our natural private brands portfolio. And 1 of them happens to be growing mid-single, 1 of them is growing about 10 and 1 of them is growing about mid-teens. So they're 3 different brands.

Operator

Your next question comes from Chuck Cerankosky from Northcoast Research.

Charles Edward Cerankosky
Northcoast Research Partners, LLC

Nice quarter. When you're talking about the new customers, how much of this is business coming back to you that might have been lost during the most difficult parts of integrating the SUPERVALU acquisition? And how much of it might be getting towards the goal of selling more organic to conventional customers and more conventional product to organic customers prior to the original goal? It's a complex question, but trying to get a sense of where the new business is all coming from.

James Alexander Miller Douglas
CEO & Director

Yes, Chuck. The simple answer is that the majority of the major gains is extending our relationship with existing customers. And it's all across the board based on what they're buying from us. We're seeing some natural customers tap into us for specialty portfolios. We recently had a large natural customer who decided to take conventional products from us. So it really does vary by customer type.

I would say if you were to say what's the direction it usually goes, it's usually us expanding natural organic or specialty into customers that don't have all 3. That would be the largest opportunity that we're activating. You don't see as many situations where conventional products go into natural retailers. In fact, you almost never do. So hopefully, that gives you some dimension on what the pipeline is.

Charles Edward Cerankosky
Northcoast Research Partners, LLC

On the conventional side, where the volume has actually slipped, Sandy, how do you see that playing out going forward, especially if the economy sort of stays where it's at where it was a lot of pressure on budget-constrained consumers?

James Alexander Miller Douglas
CEO & Director

Yes. What I'd say, Chuck, is it's very hard to paint a brush very far in retail. There are predominantly conventional retailers that are extraordinary brands and are growing very well. You see that with some of the big chains around the country but that are regional. As I mentioned earlier, predominantly conventional products, but multicultural focused retailers are putting up some of the best numbers in our system.

I think the big challenge, and the place where we have work to do with our retail, and there are others that do as well, is the more centrally positioned retailers getting a strategy that's sharper and more differentiated, at least as it's compared to the big discounters. Right now, the discounters have a fairly substantial price advantage and they're gaining share. And so there's a whole lot of work being done by the balance of the industry to find points of difference and to execute well to improve the value proposition.

Charles Edward Cerankosky
Northcoast Research Partners, LLC

All right. Thank you very much. Good luck for the rest of the year.

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Operator

Your next question comes from Scott Mushkin from R5 Capital.

Scott Andrew Mushkin
R5 Capital LLC

So I was wondering if you can give us, it sounds like you're going to give us a different kind of revenue layout next quarter. But I was wondering if you could maybe frame for us the revenue percentage associated with the legacy UNFI and the legacy SUPERVALU?

James Alexander Miller Douglas
CEO & Director

I believe we have provided that publicly. It's basically half and half.

Scott Andrew Mushkin
R5 Capital LLC

Okay. And Sandy, how integrated are the businesses? I know we used to talk about, this is a few years ago now, like 1 bill, 1 truck, like how integrated are the facilities? How integrated is -- are the 2 businesses at this stage?

James Alexander Miller Douglas
CEO & Director

The fulfillment systems are not particularly integrated. And the simple reason is that the SKUs are very different. You typically have much higher velocity SKUs in the conventional system, very often full truckload deliveries. Whereas in natural, you can find a much wider range of slower-moving products with smaller drops and multi-drop routes. And so heretofore, largely because of the interruption that COVID happened, but we've been focused on making those systems work very well. And that's where the Lean process is now engaged. And it's why we speak so optimistically about the potential of Lean because of the work ahead.

Scott Andrew Mushkin
R5 Capital LLC

Okay. And I'm sure I could dig through filings and stuff like that, but what facilities have you been closing? Are those legacy UNFI or legacy SUPERVALU?

James Alexander Miller Douglas
CEO & Director

They're all 3 of the ones that have been closed, that Matteo mentioned, Billings, Bismarck and Fort Wayne, Fort Wayne has not yet closed, are all legacy SUPERVALU warehouses. The York closure that moved over to Manchester for 50% more square feet is a Natural building, but we're automating that building, and that's all being done for growth reasons. It gives us a chance to capture what has been a DC that was operating almost at 180% of capacity. We're now able, with the automation, to continue to drive significant growth in the Mid-Atlantic market for Natural.

Giorgio Tarditi
President & CFO

Scott, all 3 of them are owned. So as we mentioned, we are starting the process to remarket these 3 properties.

Scott Andrew Mushkin
R5 Capital LLC

And the idea there, Matteo, is obviously to pay down debt with those funds?

Giorgio Tarditi
President & CFO

Number 1, 2 and 3 priorities, that's our capital allocation methodology.

Scott Andrew Mushkin
R5 Capital LLC

And do you expect that to be material?

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Giorgio Tarditi
President & CFO

We are in the process. We are not going to trade time for value. So we expect one of them to probably give us some proceeds by the end of fiscal '25 and the other 2 in the 2026 timeframe.

Scott Andrew Mushkin
R5 Capital LLC

Okay. Is there anyone else in the queue, or can I have 1 more?

Giorgio Tarditi
President & CFO

One more.

Scott Andrew Mushkin
R5 Capital LLC

Okay. So, and again, this is something that I know goes back a long time, I think we've talked about it a little bit off and on. But to get cleaner here with the business, it would be nice to get rid of retail, in my mind. Like kind of where is your head around that, Sandy, and Matteo? Like is that a possibility? I know it's so complicated up in the Twin Cities, but is that something that could go back on the table?

James Alexander Miller Douglas
CEO & Director

And I think, Scott, this is what I said last time. Everything is on the table from the standpoint that if we see a way to create more value for customers and suppliers and our shareholders, most importantly, in this case, we're going to be looking hard at it.

What I would say about retail is Cub is the #1 food store brand in the Twin Cities. It's not only owned by UNFI, it's also owned by many of our customers up there. And there's a lot of positive energy for what we can do with Cub even though it's been soft for a couple of years.

And so put all that sales and profit in one place, and it's very linked together from a customer ecosystem standpoint, it's not an easy thing to divest by itself. So the best strategy for us going forward is to keep it together and drive performance. And that's the plan that the franchisees and we have. But never say never. Obviously, we're going to do what's best for our shareholders.

Operator

Your last question comes from Mark Carden from UBS.

Mathew Scott Rothway
UBS Investment Bank, Research Division

This is Matthew Rothway on for Mark Carden. You had mentioned on the previous earnings call that you have a goal of achieving another $150 million of cost efficiencies this year. Would you be able to share any more on your outlook there and where we might be able to see that show up?

Giorgio Tarditi
President & CFO

Yes. So what we mentioned in the last call is that part of our 3-year strategic plan is to remargin the business with about $150 million of cost out to incremental margins, which as you think about is a similar envelope as we deliver in 2024 as we had a lower exit run rate, and through a lot of discipline and a lot of efforts, we were able to achieve the $580 million of EBITDA for the year.

So we are encouraged by the first quarter. We have about $1 billion of total cost to manage every quarter, and we reduced the OpEx by 65 basis points from 13.5% a year ago to 12.9% this quarter. And we're really leveraging 2 or 3 key principles. The first one is Lean daily management and the identification of waste to find new capacity and new capabilities. That is already finding routes and benefits in throughput and productivity. We were better in throughput in the last 3 quarters sequentially and improved 5% year-over-year.

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And then we continue to work on a more decentralized organization that allows more effective decision-making and also leaner teams. And we have been able to reduce the total number of employees by 5%, which is also a return to the transformation and severance investments that we made in 2024. We do that also offsetting some of the higher rents and some of the higher running costs, as you would imagine.

So I think that first quarter, as Sandy said, is early innings, but it's a good proof point of our ability to control what we can control, and knowing that through that high single-digit EBITDA growth that we provided for the next 3 years, we have a lot of variables under our control. And so we need to continue to apply Lean, continue to be disciplined and provide more proof points.

Operator

I'd now like to hand back over to Sandy Douglas for closing remarks.

James Alexander Miller Douglas
CEO & Director

Thank you, operator. As you heard on today's call, we've made progress executing our multiyear strategy and have early proof points that the strategy is taking hold and creating value for our customers and suppliers while making UNFI a more effective and efficient organization.

We delivered our fifth consecutive quarter of improving adjusted EBITDA including mid-teens growth in the quarter compared to the prior year period and meaningfully improved free cash flow compared to the first quarter of prior years. Our increased outlook reflects this performance and our confidence for the balance of the year.

We remain focused on the large opportunity for further improvement and are committed to getting better every day so we can be a clear value creator for customers, suppliers and, in turn, our shareholders. We've embraced Lean management and remain on a path to deliver improving service levels and the longer-term financial objectives we've set for ourselves.

For our customers and suppliers, we thank you for your continued partnership and the business we do together. For the UNFI associates listening today, our thanks to each of you for everything that you do for our business, our customers, our communities and each other. And for our shareholders, we thank you for the trust you continue to place in us.

Thanks again for joining us this morning. I look forward to updating you on our progress in March. And we hope everyone has a happy and healthy holiday season.

Operator
This concludes today's call. You may now disconnect. Have a happy holidays, everyone.

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