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United Natural Foods, Inc. NYSE:UNFI

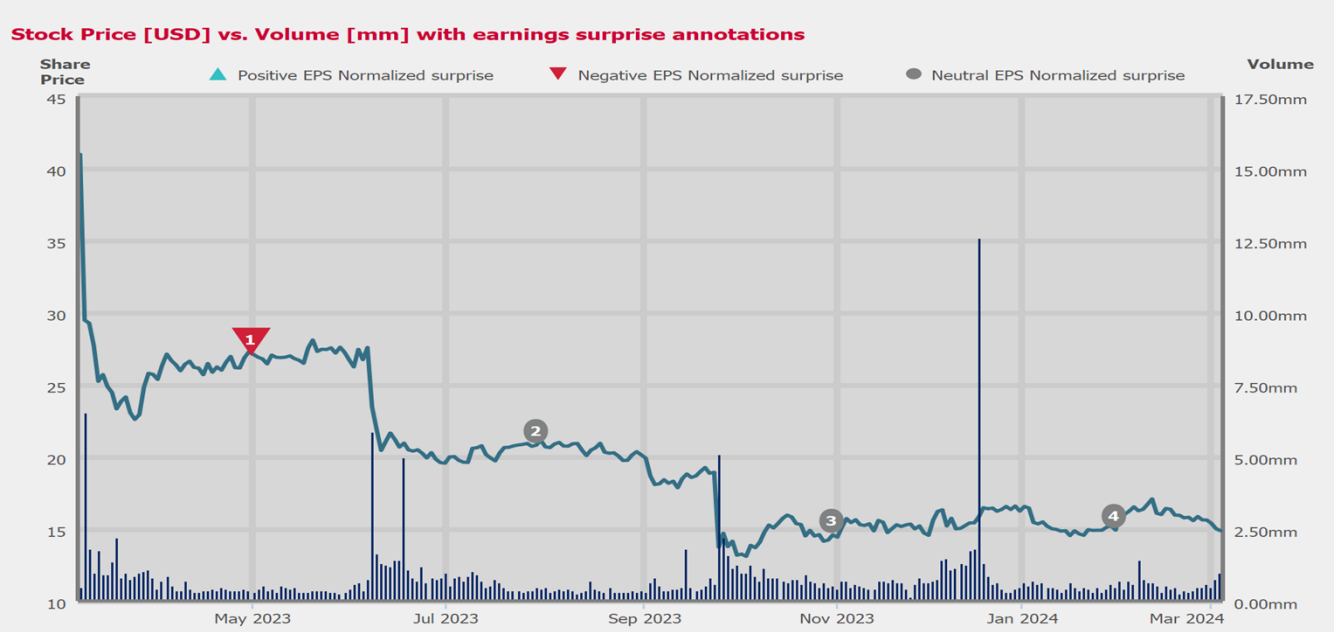
FQ2 2024 Earnings Call Transcripts

Wednesday, March 6, 2024 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2024-			-FQ3 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.02)	0.07	NM	0.10	0.08	NA
Revenue (mm)	7873.08	7775.00	▼ (1.25 %)	7588.78	31029.04	NA

Currency: USD
Consensus as of Feb-02-2024 10:18 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2023	0.65	0.54	▼ (16.92 %)
FQ4 2023	(0.39)	(0.25)	NM
FQ1 2024	(0.34)	(0.04)	NM
FQ2 2024	(0.02)	0.07	NM

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Call Participants

EXECUTIVES

James Alexander Miller Douglas
President, CEO & Director

John W. Howard
Chief Financial Officer

Steven J. Bloomquist
Vice President Investor Relations

ANALYSTS

Alexander Russell Slagle
Jefferies LLC, Research Division

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

Benjamin Wood
BMO Capital Markets Equity Research

Charles Edward Cerankosky
Northcoast Research Partners, LLC

Edward Joseph Kelly
Wells Fargo Securities, LLC, Research Division

John Edward Heinbockel
Guggenheim Securities, LLC, Research Division

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

Mark David Carden
UBS Investment Bank, Research Division

Peter Mokhlis Saleh
BTIG, LLC, Research Division

Scott Andrew Mushkin
R5 Capital LLC

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Presentation

Operator

Good morning. My name is Jeannie, and I will be your conference operator today. I would like to welcome you to the UNFI Fiscal 2024 Second Quarter Earnings Call. [Operator Instructions]

I would now like to turn the conference over to Steve Bloomquist, you may begin your conference.

Steven J. Bloomquist
Vice President Investor Relations

Good morning, everyone, and thank you for joining us on UNFI's Second Quarter Fiscal 2024 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 John Howard, our Chief Financial Officer. Sandy and John will provide a business update, after which we'll take your questions.

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

And lastly, I'd like to point out that during today's call, management will refer to certain non-GAAP financial measures. Definitions and reconciliations to the most comparable GAAP financial measures are included in our press release and the end of our earnings presentation.

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

James Alexander Miller Douglas
President, CEO & Director

Thanks, Steve. We appreciate everyone joining us for our second quarter call. In my remarks this morning, I'll provide a brief review of our results, the operating environment and the progress we're making in resetting and restoring our profitability and driving sustainable value creation for our customers, suppliers and our shareholders. I'll also discuss this morning's other release in which we announced that Matteo Tarditi will be joining UNFI later this spring as our new President and CFO.

Our second quarter results again exceeded expectations and reflected the sequential improvement in adjusted EBITDA. This resulted from continued improvements in operational execution, progress on our near-term value creation initiatives and some seasonality benefits. We accomplished this despite an industry backdrop that continues to be challenging. Inflation rates continue to decline sequentially with some category-specific deflation occurring.

Despite this trend, overall unit volumes remain under pressure and increased competition in food retail persists. Following a prolonged period of high inflation, consumers are continuing to buy less and are shifting some purchases away from the traditional grocery channel. This has led to negative volumes across the retail food industry and share gains by mass merchandisers and discounters.

Given these challenges, we are focused on strengthening and adding new capabilities in addition to driving increased efficiency across our business, so that we can help our customers remain as competitive as possible. Many of our customers are performing well even in this environment, especially those with differentiated go-to-market propositions. Importantly, we see successful food retailers positioned across the value spectrum, in both large and small markets and in natural and conventional channels. No matter how our customers are positioned in their markets, we are focused on supporting them and their unique strategies with improved efficiency, service levels and market intelligence as well as with the introduction of new products, well-executed promotions, merchandising expertise and professional services.

Similar to how our customers are setting themselves apart and creating significant value for consumers and their communities, UNFI continues to differentiate itself through continuous improvement. This includes refining operational execution, maintaining a broad diversified assortment, providing value-added services that drive cost savings and help generate growth for retailers, and driving

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supply chain efficiencies that are optimized with industry scale. We're working to realize this potential by embedding a transformation mindset across our business, focused on driving improved profitability, cost management, innovation and service levels across the short and long term.

Over the last several months, we've actioned approximately $150 million in cumulative annualized savings from the near-term efficiency initiatives, and we see opportunities to further refine and lower our cost structure. We realized additional incremental SG&A efficiencies, which are expected to benefit future profitability, while also improving our service levels and making it easier to do business with UNFI by streamlining our business. We're continuing to review our organizational composition to ensure that we are structured in a way that allows us to be focused with the needed skill sets, technology and insights to best drive profitability and growth for UNFI customers and suppliers.

We've also continued to embed improved supply chain processes and management disciplines to drive significant improvement. For example, we've achieved significant reduction in shrink. Net shrink as a percentage of sales declined both sequentially from the first quarter as well as compared to the prior year period, with shrink reduction meaningfully surpassing our prior expectations in the quarter. Importantly, we believe there's still room for further improvement.

In addition to these improvements aimed at delivering near-term profitability gains, we are working to improve our commercial go-to-market programs to better connect suppliers and enhance their ability to see, invest in and rapidly capture win-win merchandising opportunities with our shared customers. These program improvements are expected to significantly reduce operational friction. And over time, we believe it will help maximize supplier investment in our customers, which should enable them to accelerate their own profitable growth while helping UNFI to simplify our business model, drive savings and ultimately support sustainable profitable growth.

We've continued to progress on key transformation investments that are expected to structurally increase our efficiency and service levels. The automation project at our Centralia distribution center remains on track to go live later this fiscal year as does the realignment and optimization of our Northeastern distribution network currently in progress. These projects are expected to drive operational savings, increase fulfillment accuracy and create higher capacity in these geographies. We're also continuing to evaluate paths to reduce the near-term and long-term capital intensity of our distribution centers and will continue to be focused on optimizing the free cash flow profile of our network.

Additionally, we've also driven significant improvement to the online tools our customers use, which is creating a more seamless ordering experience. We remain focused on the path to driving compelling long-term value creation by transforming the efficiency, profitability and service levels of our business. We plan to build on the progress we've made so far this year as we move into the second half of fiscal 2024.

I remain confident in the opportunities that we've already begun to action to create enduring value for all our stakeholders, especially our shareholders. Importantly, while the external environment remains challenging, it continues to gradually become less volatile, which provides us a clear look at the long-term trajectory of our industry and our business, and this provides a productive backdrop for our management- and Board-led finance review that we announced on our fourth quarter call, which remains ongoing.

The group of directors leading the review on behalf of the broader Board includes our Chairman, the Chair of our Audit Committee and the 3 newest members of our Board, who joined last September. This group brings strong backgrounds and experience in finance, business transformation and strategic planning and are actively involved with our management team in assessing a broad range of potential opportunities for meaningful value creation. We'll plan to provide timely updates as the process moves forward.

Before I turn the call over to John, let me take a moment to thank him for his years of service and leadership. John helped UNFI navigate the challenges of a global pandemic, and I have appreciated his counsel and partnership during my time at the company. I know he will be a helpful partner to Matteo, too, as he works to enable a quick and smooth transition during his onboarding.

As I've said several times in the past, our philosophy is to recruit talented leaders who can help us execute our strategy and move the business forward, Matteo is a proven and experienced finance executive, who has served as CFO of several of the largest reportable segments at GE. He has extensive operating company experience and has consistently delivered results and proven to be adaptable to different businesses. He has also previously executed several transformations.

I believe this experience, combined with his strong background in process excellence is an important complement to the existing efforts that we have put in place to reset and improve our profitability. It also positions him well to augment the momentum we are building in our customer and merchandising capabilities across our existing organization. John will remain with UNFI until the end of May to help onboard Matteo and ensure a smooth transition.

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With that, let me now turn the call over to John for his remarks. John?

John W. Howard
Chief Financial Officer

Thank you, Sandy, and good morning, everyone. As Sandy just noted, today, we'll mark my last earnings call as CFO of UNFI. I look forward to partnering with Matteo during the transition over the coming months. Our finance leadership team is awaiting Matteo's start date, and we're already preparing for his onboarding process and expect a quick and smooth handoff.

As you also heard earlier from Sandy, our second quarter was ahead of our expectations, driven by solid and improving execution across the business. Our updated outlook reflects this performance balance against an environment that remains challenging with consumers seeking value as they manage household spending. This morning, I will provide commentary on the second quarter results, our balance sheet and capital structure and some considerations as we look to the balance of the year and our updated fiscal 2024 outlook.

With that, let's review our Q2 results. Turning to Slide 8. Net sales decreased 50 basis points from last year's second quarter to $7.8 billion, reflecting a continuing negative year-over-year trend in units sold that was partially offset by inflation, albeit at a decelerating rate and new business. Inflation declined by about 800 basis points compared to last year's second quarter, and we are continuing to see category-specific deflation.

As Sandy discussed in his remarks, the environment continues to be challenging for traditional grocery retailers. However, there is diverse performance across our customer base. We see this in our own results as well as with some channels continuing to grow while others face significant pressure in a highly competitive environment. Sales in our retail business declined by approximately 4.4% as we continue to be impacted by a difficult macro and industry environment. This partially reflects a significant decline in government assistance.

Flipping to Slide 9. Let's now look at our profitability drivers this quarter. Our gross profit rate prior to the noncash LIFO charge in both years decreased by about 60 basis points, which was close to our expectations. As we've previously stated, the second quarter is when we've now cycled most of the elevated procurement gains that benefited last year's gross profit rate in quarters 1 and 2. While there are still some procurement gains to be cycled in the second half, the level of gains in the prior year period is expected to decline sequentially from Q2 to Q3 and from Q3 to Q4.

As a reminder, the gains we experienced last year were driven by substantial supplier price increases that led to last year's Q2 inflation rate of about 10%, which is meaningfully higher than this quarter's rate of around 2%. The anticipated decrease in procurement gains was partially offset by continuing progress on reducing shrink, which was markedly lower than last year's second quarter.

Our operating expenses, excluding business transformation costs as a percentage of sales were down sequentially compared to the first quarter and flat versus last year's second quarter. We again saw improving throughput in our DCs, which rose by nearly 12% compared to last year's second quarter and a further decline in turnover rates. We've also seen steadily increasing outbound fill rates. These improvements were offset by DC start-up and real estate related costs, which include about $5 million related to rent, we began incurring partway through the quarter for our new Manchester, Pennsylvania DC expected to go live in fiscal 2025. This also includes continued investment in foundational initiatives designed to drive operating efficiencies and provide the highest possible service levels for our customers.

Adjusted EBITDA totaled $128 million or 1.6% of sales compared to $181 million or 2.3% of sales last year, with the difference being largely the decline in gross profit related to cycling last year's inflation-driven procurement gains. Within our retail segment, there was a $9 million sequential increase in adjusted EBITDA, primarily related to the holiday selling season. Our GAAP loss was $0.25 per share, which included $0.32 in charges primarily for business transformation costs and LIFO. Adjusting for these as well as several smaller items, our adjusted EPS totaled $0.07 compared to $0.78 per share last year, with the largest driver of the change being the lower level of adjusted EBITDA.

Moving to Slide 10. We finished the quarter with total outstanding net debt of $2.16 billion, a $124 million decrease compared to the end of the first quarter. This reflects the cash inflows from the expected lower levels of investment in working capital now that we're through the holiday selling season. We retained significant balance sheet flexibility with $1.4 billion of liquidity. We will continue to manage our debt structure consistent with optimizing our long-term credit profile and expect to maintain our base of prepayable debt including our term loan to provide capital structure flexibility as our turnaround plan and long-term strategy are implemented.

Turning to Slide 11. As outlined in our press release, we're updating our full year outlook for fiscal 2024 to reflect our performance to date and the operating environment that continues to be challenging. We've lowered the midpoint of our expectation for full year net

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sales by about 1.4% to a new range of $30.5 billion to $31 billion. For adjusted EBITDA, we've narrowed the range to $475 million to $525 million, maintaining the midpoint of $500 million, and we've updated the corresponding range for adjusted EPS, which is now expected to be a loss of $0.56 to earnings of $0.06 per share.

Our outlook for fiscal 2024 capital and cloud implementation expenditures remains at approximately $400 million, including investments in our transformation plan with the largest component going towards network optimization and automation. This also includes investments to continue to improve our technology infrastructure that we believe will drive higher efficiency. This outlook balances our year-to-date progress resetting and improving profitability and our new customer expectations with the macroeconomic and industry backdrop that remains challenging.

We expect inflation to continue to decline, but believe the pace of the decline is likely to moderate. We also continue to anticipate a more prolonged recovery for volume, but remain cautiously optimistic that these volume trends will drive increases in the quantity and depth of supplier promotions, which benefits both our customers and UNFI.

As for the balance of the year, the implied level of adjusted EBITDA for the second half of the year at the midpoint of our outlook is approximately $255 million, including about $9 million from the 53rd week in the fourth quarter. This modest acceleration includes our expectations for the continued ramp-up of our cost-saving initiatives, further incremental improvements in shrink and disciplined expense management, which will help enable investments in our new Manchester distribution center. We expect about $14 million of incremental rent and other expenses related to our Manchester DC within our second half results. Importantly, the focus of these near-term investments is largely on increasing efficiency and profitability.

In summary, as outlined on Slide 12, our updated outlook for fiscal 2024 balances the challenging operating backdrop, our performance year-to-date and a relentless focus on execution and cost management. We remain encouraged by our overall performance in the first half of our fiscal year and continue to be focused on driving profitability through efficiency and effectiveness in our supply chain and retail stores. We remain confident in our business model and transformation agenda as well as our management team and Board of Directors' ability to execute our strategy and deliver increased shareholder value.

Before we open the call for questions, I would like to thank those of you that I've interacted with over the past 5 years for your support and feedback. I'm leaving UNFI as an eager shareholder with conviction that its future is bright and Matteo will be a strong leader to support the organization.
Operator, please open the line for questions.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mark Carden with UBS.

Mark David Carden
UBS Investment Bank, Research Division

John, best of luck going forward. I wanted to start by digging into what you guys are seeing on channel shifts from traditional grocery to mass. Was this largely in line with what you guys were expecting, say, a quarter ago? Or how has this accelerated? And then how much of an impact is it having on demand for your value-added services?

James Alexander Miller Douglas
President, CEO & Director

Mark, it's Sandy. I think it's in line with trends for the most part. I think what our customers will tell you is that competition is very fierce right now. And the consumer being stressed is looking for value in a lot of ways. From a pro services standpoint, it's increasing demand for them, and it's increasing our commitment to make sure that we continue to refresh them to create more and more ways for our customers to save money so they can be more competitive.

Mark David Carden
UBS Investment Bank, Research Division

Got it. That's helpful. And then at this stage, how are you guys thinking about the level of inflation over the course of the next few quarters?

James Alexander Miller Douglas
President, CEO & Director

I think -- well, John can pile on here. As he said, obviously, year-over-year in the second quarter was a significant drop from about 10% down to 2%, and we're expecting the rate of change to moderate as we go towards the end of the year. John, do you want to add anything?

John W. Howard
Chief Financial Officer

No, I think that's exactly right. I think we'll end up in -- somewhere in between 1% and 2% in the back half of the year, but that we end our fiscal year.

Operator

Your next question comes from the line of Leah Jordan with Goldman Sachs.

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

I first wanted to ask about vendor promotions and see what you're seeing there. How are your conversations with suppliers evolving? And what's baked into guidance for the back half of the year?

James Alexander Miller Douglas
President, CEO & Director

Yes. What we're seeing, Leah, is a continued sequential increase in promotional activity, but still below what they were pre-COVID. My expectation, and I think the sense we get from meetings with suppliers is that they're going to continue to promote more aggressively and they're sequentially increasing, and that's what's in our expectations for the rest of the year.

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

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Okay. Great. And then for my follow-up, I just wanted to ask about the retail segment. We continue to see some weakness there. Just comment if -- around demand trends in the competitive environment? And then I know you made some leadership changes recently. So maybe any updates on some improvements that you made in the business there and how you're thinking about it longer term?

James Alexander Miller Douglas
President, CEO & Director

Sure. From an overall performance standpoint, obviously, it was a challenging quarter for retail. We did appoint a new CEO, Andre Persaud, who's taking a fresh look at both the Cub and the Shoppers brand. And I would say, actively consulting with our local franchisees, because Cub is a good brand. It's competing in a very challenging environment in the Twin Cities area with discounters and with mass. And Andre is looking at all aspects of our merchandising and service performance. I think our view long term is bullish relative to Cub and the potential of that brand in the Twin Cities market. And obviously, we're looking at all the ways to accelerate performance and value for shareholders through that platform.

Operator

Your next question comes from the line of John Heinbockel with Guggenheim Securities.

John Edward Heinbockel
Guggenheim Securities, LLC, Research Division

So Sandy, I want to start with -- I know you guys in the past had outlined this $40 billion existing wallet opportunity, right? So your view on that now together with the service opportunity that you see, which I think is not part of that. And then when do you think you've got still work to do? When do you think you'll be ready to provide a 3-year outlook or sort of longer-term financial targets? Is that still maybe a year away?

James Alexander Miller Douglas
President, CEO & Director

John, let me start where you started. We continue to see a very significant pipeline of opportunity, both from a new customers as well as new category perspective. And you see some of that in our performance and in our outlook. But we remain very bullish and the service opportunity continues to grow simply because the need is there. And we have a number of new services that we're working on that we're not quite ready to go public with, but we're talking with customers about to help them be more competitive.

From a longer-term perspective, and I think I mentioned this in my remarks, we're in the middle of a strategy-focused review with our Board and management team that are going to help us clarify our long-term strategy and financial plan. And I don't want to get ahead of ourselves on this. That being said, we're making good progress on it, while we're performing in a strong way relative to the efficiency programs that we've already put in place. As I highlighted last year, when we exited fiscal 2023, for example, in terms of operational improvements, shrink was running about 40 basis points above pre-COVID level. We now believe, based on the progress that we're making that we actually can trim that below pre-COVID in the reasonable near term.

So lots of work going on by the team to drive operational improvement and efficiency and improved profitability in the short term, strong process underway with our Board through financial review linked to our next strategic plan, and we're committed to giving the Street updates and more forward-looking detail when it's appropriate.

John Edward Heinbockel
Guggenheim Securities, LLC, Research Division

All right. Maybe as a follow-up, other than just growing EBITDA, when you think about deleveraging, right, creatively, whether it be asset sales, accounts receivable you monetized in the past. Is there anything interesting and not stupid, right, long term to reduce leverage quicker or it's just going to -- by definition, it's going to have to be a gradual process?

James Alexander Miller Douglas
President, CEO & Director

Yes, John, I would say that we're looking at a range of different value creation ideas through the financial review. And I would describe the ones as interesting and hopefully none that are stupid. And again, more to come on that, but we're doing a very thorough review, and we see lots of opportunity for this company.

Operator

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Your next question comes from the line of Edward Kelly with Wells Fargo.

Edward Joseph Kelly
Wells Fargo Securities, LLC, Research Division

John, best of luck moving forward. I wanted to come back to the volume side. And there's, I think, an expectation that volumes can get better from here. It's hard to know, because you don't report volumes, but it looks like volumes might be down 3%-ish or something like that. Vendors are leaning in the promos. I mean, are you seeing any elasticity benefit out of that? Are you seeing any elasticity benefit out of the fact that pricing seems to be pending? Are your customers leaning into promo as well like in addition to what the vendor is doing because you do the share stuff? I'm just trying to get a sense for what the volume picture could look like over time here? And then as it relates to all of that, what's the right level of volume growth and inflation you need in the business to drive sustained EBITDA growth over time?

James Alexander Miller Douglas
President, CEO & Director

Thanks, Ed. Let me start with sort of a few facts that may help build out the picture and then get to the more strategic element of your question. Unit growth or unit declines are fairly consistent right now as they have been over the past couple of years. And while the inflation rate is clearly significantly lower, the prices are still a lot higher than they were a couple of years ago. And I think that's weighing on consumer, certainly in the mid- and lower parts of the economy. And that's creating an opportunity for discounters and math that consumers are responding to. Promotions are increasing, as I mentioned, and retailers are promoting as well to be competitive.

Inside the sort of retail detail, customer counts are healthy still, but baskets are going down. And I think that has to do with some category trading. Our growth going forward and this gets to the latter part of your question is going to be a function of more customers, more categories and then our ability to work with them to -- for them to be as healthy and profitable as possible. And clearly, we think profitable growth is part of our algorithm going forward, but I emphasize profitable growth.

Edward Joseph Kelly
Wells Fargo Securities, LLC, Research Division

Okay. And then as it pertains to procurement gains, have you now fully worked your way through those. So the EBITDA that you're reporting now is what you would consider more normalized? And then on the flip side of that, you talked about vendor promotions rising, obviously levels are below 2019. Is there a way to frame what the opportunity is related to that for you as we think about like levels of EBITDA?

James Alexander Miller Douglas
President, CEO & Director

Yes. So the way I'd describe the procurement gains is they're substantially annualized, although they still had some in the third quarter last year and then, again, tapering further in the fourth quarter and into this fiscal. In terms of profitability, I think a good way to look at it is sequentially as opposed to year-over-year, and our profitability improved in the second quarter versus the first quarter and the first quarter versus the fourth quarter of last year, some of that being driven by holiday seasonality in what is our second quarter, but also the actions that we're taking to drive incremental profitability into the business, which will continue.

From a promotion standpoint, there's a lot of ways that suppliers are investing in the market. They're investing through promotions. They're investing through new items. And they're investing through various media investments, some in partnership with retailers and some over the top. And we're seeing increases in all of those. And our strategy is, as I mentioned, to try to help suppliers see our customer base. Our customer base is vibrant with all kinds of positionings really across the country, over 30,000 outlets.

So to the extent that suppliers can see all of them, not just the big ones, they can quantify the opportunity, watch the returns that they get. We believe that gets the flywheel going. And the more successful that consumer products companies are with independents, the more profitable and successful they'll be over time.

Operator

Your next question comes from the line of Scott Mushkin with R5 Capital.

Scott Andrew Mushkin
R5 Capital LLC

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Just first of all, John, it's been an absolute pleasure working with you, so good luck going forward. So actually, I wanted to jump on the answer that Sandy gave to the last question. It seems -- and maybe it's because of the ads that some of these -- the advertising businesses that some of these large retailers have that our research would say the vendor promotions are not necessarily being spread equally across the market, favoring some -- maybe some larger retailers. How do you stop that? How do you kind of work against that as we move forward and promotions can probably continue to go higher?

James Alexander Miller Douglas
President, CEO & Director

So Scott, I'll editorialize a little bit and then come back to your question. My experience in consumer products over many years, is that the diversity of the customer base is an extreme value driver for consumer products companies. So the conversations we're having with the commercial leaders, chief customer officers, North America presidents is really advocating for that strategic focus. Now a successful consumer products company is going to work with all retailers and certainly focus on big ones. But the unlock is to drive accelerated growth with independents.

Our job is to help them do that, help them see it, streamline and simplify how we work together and have them begin the investment return measurement, invest again. Consumer products companies are very sophisticated and they see growth when it works and they see profitable growth when it works well, and that's our focus with them. And I think we will end up being able to earn our fair share or hopefully a little more for our customers by virtue of their ability to see the return that they can get.

The final point is relative to advertising businesses, I think that's an opportunity. Retail media through an independent lens would be incredibly successful if it can be executed. And obviously, we're focusing on ways in which we might be able to help with that.

Scott Andrew Mushkin
R5 Capital LLC

All right. Perfect. And then actually I've got two others, if I could slip them in. So first of all, on the CapEx going forward, I guess it's about $400 million this year. When do you expect maybe that will come down? Do you expect it to come down? So that's number one.

And the second is, again, more strategic. It has to do with Cub. Originally, when the merger was done and the thought was that Cub would be sold, is that still on the table? Or is that -- hey, this is -- that's really not on the table?

James Alexander Miller Douglas
President, CEO & Director

Scott, let me start with the second one first. We believe the Cub brand is a very viable brand and has a lot of success ahead in its future. One of the interesting parts of the model is that a significant part of it is franchise and some of the leading retailers in Twin Cities are in the brand. And with Andre joining the company, we're engaged heavily with our franchisees to discuss the best ways to drive the brand forward and a number of very good ideas are on the table. And so we will continue to do that in a way that's good for the brand, good for the franchisees and good for our shareholders.

Relative to capital and the outlook there, as I mentioned earlier in my script, we're in the middle of a next 3-year plan process and a financial review with our Board, capital intensity is an important part of the focus of that conversation. And we're employing the 0-based philosophy that we used for overall planning to capital planning as well, and we'll have more to talk about it at an appropriate time.

Operator

Your next question comes from the line of Chuck Cerankosky with Northcoast Research.

Charles Edward Cerankosky
Northcoast Research Partners, LLC

In looking at the quest to grow your volume and improve your volumes, can you talk about private label? You don't have much, if any, in the way of manufacturing. How do you get that in the loop while at the same time, not annoying the CPGs, but it seems to be incredibly important as consumers are looking for value and lower prices, et cetera?

James Alexander Miller Douglas
President, CEO & Director

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Yes. Chuck, extremely good point. I mean we're focused on private brands as an important part of the value proposition that we bring to our customers. And we've done a bunch of work on it actually. We recruited top talent into that. We kind of streamlined out of a lot of little ideas into some big portfolios that fit the various positionings of our customers. And we're focused on helping our retailers be very competitive in private or exclusive brands. So I agree with the thesis of your question.

Operator

Your next question comes from the line of Kelly Bania with BMO Capital Markets.

Benjamin Wood
BMO Capital Markets Equity Research

This is Ben Wood on behalf of Kelly. Good luck, John, on your future endeavors.

John W. Howard
Chief Financial Officer

Appreciate that, Ben.

Benjamin Wood
BMO Capital Markets Equity Research

Our first question is we've been hearing that UNFI recently introduced a new simplified approach to supplier fee structures. Would you be able to expand on that initiative? What's the thought process behind it? What are the efficient fees or incremental business you hope to gain from it?

James Alexander Miller Douglas
President, CEO & Director

Sure. And Ben, it's early in the launch process, but you described it well. It's a new way of working with our suppliers that will enable them to have access to data and insights and a faster, more flexible relationship with us that really is the design of which is to simplify their ability to get their new items to get their investment, their promotions to our customers easier, faster, quicker. We have traditionally had a very fee-based approach to how we work with suppliers. And what we're doing is we're eliminating a lot of that and creating a much simpler relationship, so that they'll be able to make a simple investment and then we put their focus and our focus on driving value to the shelf. More details to come, it's early, but at this stage, we're in the rollout mode.

Benjamin Wood
BMO Capital Markets Equity Research

Great. And then I just wanted to dig into gross margins a little bit. Understanding in 2Q, you guys were still lapping some procurement gains. It looks as like there should be some mix shift pressure between the segments and then potentially offset by increases in promotions. So our question is, when should gross margins start to stabilize? What are the major puts and takes from -- in gross margin in the second half, maybe compared to Q2 as well?

John W. Howard
Chief Financial Officer

Yes, Ben, this is John. I'll start. The -- so we generally don't provide guidance on gross margin, just the sales and EBITDA, EPS. We have, as you might imagine, a lot of puts and takes and margin, all of which I think we've talked about between promo spend, the improvements and strength that we're seeing, the forward buy that we're lapping mostly through the first half of this year. So again, the guidance that we provided for EBITDA reflects how we're thinking about the margin and the rate. And what we're anticipating is as Sandy has mentioned, that promo spend will continue to tick up. We'll start to see or continue to see the improvements in shrink, but we still have the margin pressure in general that we're seeing within the industry. Sandy, anything to add to that?

James Alexander Miller Douglas
President, CEO & Director

No, I think you said it well.

Operator

Your next question comes from the line of Andrew Wolf with CL King.

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

Sandy, I wanted to sort of maybe a follow-on to what Scott was asking about capital expenditures. Could you just kind of review and discuss, give us as much additional information or insight as you wish on kind of the business case for automation at the distribution centers? You have some trails you're going to open. And I think you announced a new one. Is this like a sea change in the cost structure? Is it incremental? Is it kind of defensive because the price of -- the cost of labor has gone up? How do you really view the opportunity for a reasonably well large capitalized business as to go through an automation transformation?

James Alexander Miller Douglas
President, CEO & Director

So thanks, Andy. You articulated some of the big strokes of the case. We believe that automation enables us over time to materially enhance capability, load quality, the layout of how pallets are distributed and organized for retailers based on how their shelves are set. It drives efficiency. It's obviously more friendly from a labor perspective, which is a labor scarcity issue more than anything else. It also allows us to drive very efficient growth in the distribution center. And I think that's a big part of the case. Ultimately, we see the network optimization and organizing our DCs and automation as being part and parcel of each other and the ultimate payoff is return on invested capital, better customer service and more profitable growth.

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

Okay. I see them being related. I can see them both being helpful. But I assume this is -- could you somehow at least qualitatively discuss where it is between a sea change and the cost structure and just an incremental and/or even a defensive type of investment? Defensive meaning to maintain your margins -- profit margins and sea change meaning a big increase.

James Alexander Miller Douglas
President, CEO & Director

Yes. I think it's incremental more than a sea change, largely because it's something we have to do in an extremely disciplined way, because it fits certain situations and doesn't fit others. And as a part of our overall financial review, we're working through that in a much more granular and disciplined way. But we have high expectations for it in the market situations we've put it in, and we think it incrementally improves our financials and our returns on capital.

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

Okay. And also a follow-up on the $150 million of shrink and other cost savings that you've, I think, identified. And I think just kind of 2 things about that. One, it sounds like you've added to it. Is that enough that you could say how much more it might have been added to that? And two, where are you at in realizing it? Is it a full run rate? Is it $150 million divided by 4? Or is it going to be cumulative? Is it less than that and there is accumulating, it's increasing?

James Alexander Miller Douglas
President, CEO & Director

So Andy, let me try to unpack it at least as far as we've been public about it. We've actioned $150 million run rate savings. Shrink improvement is not in the $150 million of savings and the incremental work we've done around spans and layers, which is relatively small compared to the $150 million, would be incremental and is going forward, and that's in process now. What I would further say is that streamlining and improving the efficiency of this company is going to be our work forever. And that effort will continue with each quarter and year coming. But the $150 million is actioned, the shrink is incremental and the spans and layers is incremental, but small compared to the $150 million, and it's in process.

Operator

Your next question comes from the line of Alex Slagle with Jefferies.

Alexander Russell Slagle
Jefferies LLC, Research Division

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I'm wondering if you could talk to turnover levels and productivity improvements, just related to tenure and training and how impactful these have been in the relative margin improvements you've seen? And maybe what the path looks like going forward, just more room to go or have really the biggest gains been captured at this point?

James Alexander Miller Douglas
President, CEO & Director

So I'm going to make a summary comment, and then I'm going to ask John to fill in with detail. We saw market improvement in our throughput in our DCs and significant component of that is increased tenure of associates. In addition, the driver of it is process improvements, which are a driver not only of productivity, but also a driver of the reduction in shrink. Much like SG&A savings, we think operational productivity is a constant effort. And I would say we continue to have significant opportunity for improvement there. But the specific answer to your question is we're seeing throughput grow, 10-year increase as the workforce stabilizes.

John, do you want to put anything more on that?

John W. Howard
Chief Financial Officer

No, I think that's right. I think we mentioned in the first quarter that we've seen progress on lowering the vacancy rate, and we continue to see that improve in Q2. We also said, as Sandy suggested the throughput, that throughput was actually the highest it's been in the last 2 years in Q1, and we've seen that level continue to improve also in Q2 and that's a direct result of what Sandy just said. It's a result of the new processes, our standard operating procedures, some additional warehouse technology we put in place. So we're seeing the results come through in our OpEx.

Alexander Russell Slagle
Jefferies LLC, Research Division

Got it. And any high-level guardrails and thinking about 3Q profitability as you sort of evaluate where 2Q came out and there were timing of cost saves or a bigger ramp in the shrink reduction that maybe had an outsized benefit in the quarter? Just trying to get a view on the third quarter from that perspective.

James Alexander Miller Douglas
President, CEO & Director

Yes. I think John said in his prepared remarks very well. We -- our guidance implies $255 million of EBITDA in the second half. The fourth quarter had an extra week, which is about $9 million. And that would be all that we've said about the pacing.

Operator

And your last question for today comes from the line of Peter Saleh with BTIG.

Peter Mokhlis Saleh
BTIG, LLC, Research Division

Great. I may have missed this. Did you guys give us an exact amount of where we were on shrink? I know pre-pandemic, I think it was 20 basis points. And last we heard, we were running, I don't know, maybe [60] basis points or so of shrink. Just trying to understand exactly where we are today given the progress you've made on shrink?

James Alexander Miller Douglas
President, CEO & Director

Yes. I think the numbers you just provided are consistent with what we've said before. And what we said today is that we've made significant progress, in fact, more progress than we'd expect it to make, and I'm happy to see that because this is pure waste. So -- and then I think commented further that we actually see the opportunity going forward to get to new lows below pre-COVID. So we've made material progress on it. We have more progress to go.

Peter Mokhlis Saleh
BTIG, LLC, Research Division

Great. And then Sandy, on that progress to be better than pre-COVID on shrink, is that something you foresee in the near term? Or is that more of a multiyear kind of initiative? Just trying to understand the time line on getting to those levels.

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James Alexander Miller Douglas
President, CEO & Director

Yes. That's, Peter, we haven't obviously given in go-forward guidance. I think I'm just pointing to it as an operational opportunity and something that we've got conviction on.

Operator

I will now turn the call back over to Sandy Douglas for closing remarks.

James Alexander Miller Douglas
President, CEO & Director

Thanks, operator, and thanks to everybody for joining us this morning. Our team is committed to sustaining our operational momentum as we look to the balance of fiscal 2024. We remain confident in our multiyear improvement plan. As a result, we believe we have a compelling opportunity to create sustainable value for our customers, suppliers and our shareholders through our scale, enhanced capabilities, efficiency initiatives and profitability focus. We're optimistic we'll build on the progress we've made in our first half, and we look forward to continuing to update you on this. .

I also want to thank John Howard for his leadership over the last 5 years and for the support that he's provided to me when I joined UNFI. John, on behalf of UNFI, we wish you all the best.

And finally, 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, and I look forward to updating you in June with Matteo.

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

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