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UNFI - Q4 2016 United Natural Foods Inc Earnings Call

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OVERVIEW:

Co. reported 4Q16 net sales of \$2.21b and net income of \$34.7m or \$0.69 per share.
Expects FY17 sales to be \$9.43-9.60b and GAAP diluted EPS to be \$2.53-2.63.



CORPORATE PARTICIPANTS

Halie O'Shea *United Natural Foods Inc. - Director of IR and Corporate Strategy*

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PRESENTATION

Operator

Welcome to the United Natural Foods fourth quarter 2016 earnings conference call.

(Operator Instructions)

I would now like to turn the conference over to your host, Halie O'Shea, Director of Investor Relations and Corporate Strategy. Thank you. You may now begin.

Halie O'Shea - *United Natural Foods Inc. - Director of IR and Corporate Strategy*

Thank you, Shay. Good afternoon and thank you for joining us on UNFI's fourth quarter and full-year FY16 earnings conference call. By now, you should have received a copy of the earnings release issued this afternoon at approximately 4:05 PM Eastern time. This press release and webcast of today's call are available under the Investors section of the Company's website at www.unfi.com.

On the call today are Steve Spinner, President and CEO; Sean Griffin, Chief Operating Officer; and Mike Zechmeister, Chief Financial Officer. Before we begin, we would like to remind everyone that comments made by management during today's call may contain forward-looking statements. These forward-looking statements assess plans, expectations, estimates, and projections that might involve significant risks and uncertainties.

Actual results may differ materially from the results discussed in these forward-looking statements. In addition, in today's earnings release and during the call, management will provide GAAP and non-GAAP financial measures. These non-GAAP financial measures include adjusted net sales, adjusted net income, adjusted earnings per diluted share, EBITDA and free cash flow. I'd now like to turn the call over to Steve Spinner.

Steve Spinner - *United Natural Foods Inc. - President & CEO*

God afternoon. Thank you, Halie, and welcome to the team. As many of you may or may not know, Halie O'Shea is UNFI's new Director of Investor Relations and Corporate Strategy, so welcome. We are pleased with UNFI's execution of our strategic initiatives in FY16.



Three years ago, we made the strategic decision to shift our business from a focus on center of the store to capture the faster growing fresh and good-for-you protein specialty cheese, deli and produce. This year, we have started to see the work and strategic investments behind this initiative pay off.

During a year when we faced a more volatile and competitive marketplace, we have grown our fresh business to represent approximately 15% of our total sales. Our net sales grew 8%, adjusted for the termination of a customer distribution contract and the second quarter FY15 reduction in net sales, or 3.5% on a GAAP basis and EBITDA was \$295.1 million, with GAAP net income of \$125.8 million.

Importantly, this was accomplished despite industry challenges, including slower same-store sales growth rates across many key customers, less inflation and competitive pricing dynamics. In addition, as many of you know, we started the year with a strong headwind as a result of our decision to terminate a significant customer relationship.

We also generated cost savings and greater efficiencies across the organization. In FY16, we delivered exemplary customer fill rates and our productivity improved by 5% while our transportation costs were down 6%. On time deliveries, which we track through on board computers installed throughout our network, also improved over 94% on time which is truly astounding.

We generated \$255.2 million in free cash flow which is the most we have ever generated in a fiscal year and over \$300 million better than FY15. As previously announced, during the year, UNFI secured over \$1 billion in customer contract extensions and renewals.

Going forward, our team remains intently focused on our strategy of building out our fresh and specialty product offering through a mission of providing retailers eCommerce and food service customers with the most comprehensive selection of better-for-you consumer products. In the past 12 months, we have made great strides in our Building Out the Store strategy through the acquisition of four exciting and uniquely positioned companies including Haddon House Specialty Foods, Global Organic, Nor-Cal, and Gourmet Guru.

UNFI is now positioned as a large national provider of fresh produce, proteins, bakery, deli, specialty, and natural products, with a fully-deployed service-based sales team in both the United States and Canada.

For retailers, UNFI makes it easy to source and deliver products for everything that is healthy and better for you, across all channels, with a single point of distribution for fresh and grocery; highly efficient distribution network, no more than 200 miles from 75% of the US and Canadian markets; full service merchandising team with over 1,000 associates in the field, working on behalf of manufacturers and retailers to planogram; manage the shelf and drive sales; and a broad product offering across specialty, gourmet, ethnic, center store, organic, dairy, protein, cheese, deli, food service, produce, floral, personal care, and non-foods.

This past August, we completed our conversion into one national sales force with singular representation across our customers. Prior to this change, UNFI called on our retailers using sales teams from each of our operating units. Additionally, we are now structured into three regions, each having a management team to make decisions close to the customer and the market.

This exciting change brings us to our customer more frequently with all of our service offerings. Resulting from this re-organization, we anticipate identifying and taking advantage of sales opportunities which are brought forward through our customers having a single point of contact for all of UNFI's products and services.

A couple of comments on our recently acquired businesses. Haddon House Specialty Foods, the distributor and merchandiser of natural, organic and gourmet ethnic products, had significantly increased and improved our food service merchandising business using our teams to reset planogram and manage our products at the shelf. David Anderson, Sr., and David Anderson, Jr., continue to lead UNFI Specialty business as we deploy this very unique and strategic model across the US.

Our next strategic act section was Global Organic, a fresh perimeter Company based in Sarasota, Florida, which accelerated our roll-out of perishable fruits, vegetables, dairy, protein and related products in Florida. As we have said previously, Global Organic is physically located adjacent to UNFI's Albert's Organic Sarasota distribution center and we have now integrated them into our distribution network and organizational structure.

Nor-Cal Produce, based in Northern California, will serve as the basis for our drive toward a national conventional produce program. Working with Albert's, we see significant opportunities as this business is integrated into our national fresh distribution platform. Todd Achondo, President of Nor-Cal, will continue to play a significant role in our fresh deployment strategy.

Most recently, after the fiscal year end, we acquired Gourmet Guru, a distributor and merchandiser of fresh and organic foods, with expertise in cultivating exciting new and emerging brands. Led by Jeff Lichtenstein, Gourmet Guru brings UNFI's diverse skills and merchandising, with a high touch in-store service model. This acquisition, headquartered in New York City, is now a part of our UNFI Next division run by Kirsten Hogan.

UNFI Next is working closely with suppliers to deploy joint marketing, merchandising and distribution programs in key urban markets across the country. With these acquisitions, we have added more than \$700 million in revenue and roughly a 1,000 associates and can now offer our customers more than 100,000 different products.

As we enter FY17, we believe we are well-positioned to provide a wide range of diverse products and services to every retailer across the US and Canada. In FY17, we will continue our Building out the Store initiative. We will work to integrate our recent acquisitions and we will continue to build-out our platform with selective and opportunistic M&A.

We believe our increasing exposure to the faster growing, perishable, healthy-for-you products positions us uniquely well as we continue to face industry headwinds related to the hypercompetitive nature of our industry and distribution and retailer. Lastly, UNFI remains resolute in its commitment to doing what's right.

During 2016, the UNFI Foundation, which is focused on promoting healthy organic food systems, donated more than \$580,000 to non-profit organizations in 23 US states. In addition, our associates volunteered over 11,000 hours to service projects and UNFI donated more than 13 million pounds of food through feeding America's network of food banks.

Also we recycled 24,700 tons of waste and we diverted 76% of our operational waste from landfills, a 9% improvement over the prior year. We believe UNFI is better positioned for further growth in sales and profitability than ever before. Our four acquisitions strengthened our foundation and UNFI is uniquely positioned to service customers across every channel of food retail in the US and Canada.

This is an exciting time for UNFI as we embark on our next stage of growth. Our fresh distribution network, our capital structure, our breadth of product offering, and most importantly, our people, all contribute to the strength of UNFI's position in the marketplace today.

Now before I turn the call over to Mike to discuss the financials, I just want to comment on some of the headlines in recent weeks. Some of our publicly traded food retailers have recently commented that they are experiencing slower same-store sales trends and ongoing pressure from food deflation. We believe our guidance for FY17 incorporates a still challenging and difficult food retail environment as well as little to no inflation; however, as always, we are intently watching and listening to our customers and now, I'll turn the call over to Mike Zechmeister, our Chief Financial Officer.

Mike Zechmeister - *United Natural Foods Inc. - CFO*

Thanks, Steve. Good afternoon, everyone. Net sales for the fourth quarter of FY16 were \$2.21 billion, which represents growth of 7.4% compared to fourth quarter of last year. Excluding the year-over-year impact of the previously disclosed termination of a customer distribution contract, our net sales growth for fourth quarter increased 12.7% compared to the same period last year.

The acquisitions of Nor-Cal Produce and Haddon House Food Products contributed approximately \$138 million of net sales in the fourth quarter. Excluding Nor-Cal and Haddon House acquisitions, the impact and the impact of the customer contract termination, net sales grew 5.7% in the fourth quarter versus Q4 last year. Global Organic, which was acquired in March, was integrated into our Albert's business in Q4 and therefore, is no longer separable from the underlying business.

Inflation was essentially flat at only plus 3 basis points versus fourth quarter last year. This marks the lowest level of quarterly inflation in at least seven years. While we saw modest inflation across the center of the store, we experienced deflation across our fresh business. From a channel perspective, Super Natural's net sales in Q4 were up 4.0% over the prior year and represented approximately 33% of our total UNFI sales.

Supermarkets sales increased 4.4% versus the prior year and landed at 28.2% of total sales. Excluding the Nor-Cal and Haddon House acquisitions, and the customer contract termination, supermarkets grew approximately 7.9% in the quarter versus last year. The independent channel grew at 11.7% over the prior year, including the impact of recent acquisitions, and represented 27.8% of total UNFI sales in the fourth quarter.

Excluding the Nor-Cal and Haddon House acquisitions, the growth of our independent business was 4.2% in the fourth quarter versus Q4 last year. Finally, food service net sales were up 13.0% over the prior year and eCommerce sales were up about 23.8% over prior year. Neither food service nor eCommerce were significantly impacted by the recent acquisitions.

Gross margin for the quarter came in at 15.60%, an increase of 25 basis points over last year. The Q4 increase versus prior year was driven by acquisitions. Excluding acquisitions, gross margin would have been down for the quarter versus Q4 last year, as we continue to face competitive pricing pressure, moderated supplier promotional activity and a reduction in fuel surcharges.

Our operating expenses for the quarter were 12.78% of net sales for fourth quarter of FY16, a 59 basis point increase compared to fourth quarter of FY15. The Q4 increase was primarily driven by operating expenses from acquisitions recorded in the fourth quarter of FY16, which included \$2.0 million of amortization costs and reduced incentive compensation in the fourth quarter of last fiscal year.

Total operating expenses for Q4 of FY15 included approximately \$0.8 million of restructuring and impairment costs related to the Company's retail business and \$0.3 million of acquisition costs. Q4 total fuel costs decreased 15 basis points as a percent of net sales compared to fourth quarter of FY15 and represented 44 basis points of distribution net sales.

Our diesel fuel costs per gallon increased 22.9% in the fourth quarter versus the same period last year. The Department of Energy's national average price per gallon for diesel was down approximately 16%, or \$0.46 a gallon compared to Q4 last year. Sequentially, total fuel costs as a percent of net sales were up 5 basis points, driven by the 23.3% increase in market price for diesel fuel per gallon in Q4 over Q3 of FY16.

Share-based compensation expense was higher on a dollar basis in the fourth quarter of FY16 at \$2.6 million compared to \$2.0 million in FY15, representing 12 basis points of net sales compared to 10 basis points in FY15.

Operating income was \$62.5 million for the fourth quarter of FY16, a decrease of 4% versus same period last year. Our operating margin was 2.82%, a 34 basis point decrease versus fourth quarter of 2015.

Interest expense in Q4 was \$4.5 million, an increase of \$0.8 million versus last year's fourth quarter due to additional debt resulting from the acquisitions closed in FY16. During the fourth quarter, we entered into paid fixed rate and received floating rate swaps in the amounts of \$100 million for three years and \$50 million for five years. These swaps are aligned with debt of the same amounts in our credit facility and fixes the current interest rate at 1.8% for the three-year portion and 2.0% for the five-year portion.

After the quarter end, we renegotiated the interest rate on the \$130 million outstanding balance on our term loan. As a result, interest rate will drop by 75 basis points to approximately 3.55% as of September 1, 2016.

For the fourth quarter of FY16, the Company reported net income of \$34.7 million, or \$0.69 per diluted share, a decrease of approximately 3.9% versus Q4 of last year. Excluding approximately \$0.8 million of restructuring and impairment costs related to the Company's retail business, and \$0.3 million of acquisition-related costs, adjusted net income from Q4 of FY16 was \$35.3 million and adjusted diluted EPS was \$0.70 per diluted share.

Total working capital at the end of Q4 was \$1.0 billion, down 2.6% versus fourth quarter of last year, a net sales growth of 7.4%. Working capital performance in Q4 versus the prior year was driven by improvements in day sales outstanding, days in inventory and reduced capital expenditures.

Capital expenditures were approximately \$12.3 million in the fourth quarter, or 0.56% of sales compared to 1.5% of net sales in the fourth quarter of FY15.

For FY16, capital expenditures were \$41.4 million, or 0.49% of net sales with the largest investment related to the opening of our new facility in Gilroy, California. Due to our capacity building efforts over the past two years, FY16 represented the lowest level of capital expenditures as a percent of net sales in over five years. For FY15, capital expenditures were \$129.1 million, or 1.58% of net sales.

Outstanding lender commitments under our credit facility were \$833 million at the year-end, with available liquidity of approximately \$387.3 million, including cash and cash equivalents. Our debt to EBITDA leverage at the end of FY16 was 2.04 times versus 1.8 times at the end of FY15.

Cash flow from operations in Q4 was \$91.0 million, an increase of \$35.9 million over fourth quarter last year and for the quarter, we generated free cash flow of \$78.7 million compared to \$24.5 million last year. For the full year, we generated free cash flow of \$255.2 million, up \$335.5 million from FY15. This represents the highest fiscal year of free cash flow in Company history.

As discussed in the press release, we expect FY17 sales to be in the range of \$9.43 billion to \$9.60 billion, an increase of approximately 11.3% to 13.3% over FY16. GAAP earnings per share for FY17 are expected to be in the range of \$2.53 to \$2.63 per diluted share, an increase of approximately 1.2% to 5.2% over FY16 GAAP earnings per diluted share. We expect capital expenditures for FY17 to be in the range of \$55 million to \$80 million, or approximately 0.6% to 0.8% of estimated FY17 net sales.

We expect free cash flow to be in the range of \$120 million to \$150 million and finally, we anticipate our tax rate to be 39.7% to 40.1%. Given recent acquisitions, we also wanted to provide more color on their impact. While our strategy to Build out the Store remains the same, our recent acquisitions involve -- evolve our margin structure going forward.

Including recent acquisitions, we expect to deliver higher gross margins with higher operating expenses, resulting in EBITDA margins that are generally consistent with our base business. In addition, in FY17, we expect to have a step-up in depreciation and amortization expense of approximately \$20 million, driven by acquisitions. We also expect to incur increased compensation expense in FY17, due to increased stock-based compensation and the restoration of performance-based incentives.

Looking beyond 2017, our longer-term growth model is expected to generate mid- to high single digit net sales growth, with 1 percentage point or 2 percentage points of that coming from acquisitions. We also anticipate modest gross margin contraction on our base business, offset by operating expense reductions to yield flat EBITDA margins going forward. With that, we would like to open up the call for Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from John Heinbockel from Guggenheim Securities.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

So Steve, let me start with capacity utilization in the warehouses. So where do you think you stand right now? I'm curious, in particular, the newer facilities. Where do you -- and where do you think you'll be based on your 2017 guidance? Where do you think you'll be at the end of 2017?



Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, hi, John. The nice thing about having built capacity is we have capacity so we are certainly focused on filling those buildings up but I'm going to defer the answer to the question to Shawn, who is sitting next to me, and he can give you some of the specific details around capacity.

Sean Griffin - *United Natural Foods Inc. - COO*

Hey John. Good afternoon. So what we're looking for, from a utilization perspective out of our network, that we believe is optimum is in the range of approximately 85% capacity. It's our best perspective around productivity and service as well as giving us some flex around new customer wins, so today, with the addition of Gilroy, our capacity is in the mid-70%, so you can kind of do the modeling between mid-70% to 85% based upon FY17's revenue guidance to come up with our opportunity to add business without doing any further expansions.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

So ex-Gilroy, you would be where?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Well, I don't know that we can get into that much detail, but maybe directionally, high 70%? Low 80%?

Sean Griffin - *United Natural Foods Inc. - COO*

78%, somewhere in there.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Okay, and the \$1 billion of renewed or extended business, I'm curious how much of that was previously done direct by your retail customers versus maybe other distributors and I assume that would be maybe incorrectly but that would be lower margin than your base business, and if that's true, how would the margin on that \$1 billion compare to renewals from the prior year?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, the vast majority of the \$1 billion was related to renewals, extensions and expansions and so they have been throughout FY16. Some contracts were expiring, some were not, which is both customer and UNFI felt it was important to go ahead and do those early and so they don't really relate to new contract wins but more renegotiations, new contracts with existing customers. For the most part, if you look at the gross margin throughout our FY16, we had contraction and a lot of it was related to the competitive environment and the renewals in these contracts.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Okay and then just lastly, the roll-out of national -- the national roll-out of conventional produce, so what's the time table on that?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

We feel that, that's a little bit of a competitive advantage for us to kind of keep that under wraps for awhile. We have a strong, really strong, I think leading conventional produce acquirer, one of the leading conventional produce acquirers from a quality perspective in Nor-Cal and you could



use a little common sense and determine where we were going to bring conventional next but I think as we get further deployed, we will probably be in a position to answer that question with more clarity (inaudible)

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Do you think they move eastward across the country? Is that the idea, organically, until you buy somebody or not?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

It's a little bit of both. It's a little bit of existing customers looking for us to satisfy their conventional produce needs in the same way we are already satisfying organic needs. It's contiguous markets, so it's a little bit of both.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Okay thank you.

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Okay, John.

Operator

Thank you. Our next question comes from Scott Mushkin from Wolfe Research.

Brian Cullinane - *Wolfe Research - Analyst*

Hi, this is Brian Cullinane for Scott. Thanks for taking the question. Just wanted to touch on a couple of things. First on maybe the inflation/deflation environment. How do you guys see overall, it's overall, you said that it's a little bit inflationary with some deflation in some of the fresh categories. Your distribution model, how do you think that handles that in comparison to your retail customers? Is it simply just passing on through or how do you guys see that (multiple speakers) --

Steve Spinner - *United Natural Foods Inc. - President & CEO*

As a distributor, that's primarily cost plus. The math works against us when we don't have 3% inflation, right? So 3% inflation, we pass it through and the math works in our favor because we're using percentages and we're delivering the same case but getting a little bit more margin where we have no inflation. It's just a little harder. We still have to ship the same case and it still costs us the same, we're just generating less margin.

Sean Griffin - *United Natural Foods Inc. - COO*

If I may also, that, when we are in periods of high product cost inflation, our opportunity from a buy side, from a purchasing side, from an inventory optimization side improves, so we have incremental gross margin gains as a result of forward buying against those product cost increases.

Brian Cullinane - *Wolfe Research - Analyst*

Got you. That's helpful and then this is, I guess maybe a little bigger picture but as you evaluate like a new customer, how much do you guys look at like the health of their business like, say, there's some kind of local grocers that are struggling or -- and if there maybe is the potential to go into restructuring or something like that, how much do you take that into account as you're working for the new business?

Mike Zechmeister - *United Natural Foods Inc. - CFO*

Brian, this is Mike. The credit worthiness of customers is certainly part of the equation and the evaluation that goes into how we establish the contract and also, our expectations in the contract and as you can imagine, there's a full range of folks that we're dealing with. We try to support our customers in the best way that we can, try to encourage a good business but at the end of the we've got to make sure we've captured the risk associated with credit as we establish any contract.

Brian Cullinane - *Wolfe Research - Analyst*

That's helpful. Thanks for taking the question.

Operator

Thank you. Our next question comes from Rupesh Parikh from Oppenheimer & Company.

Rupesh Parikh - *Oppenheimer & Co. - Analyst*

Thanks for taking my questions. So Steve, I wanted to start first with a higher-level question. So we've clearly seen all of the challenging reports from all the grocers out there so just curious, from your perspective, and as you look through your lens, are you seeing anything else out there that could explain some of the weakness out there besides just a hypercompetitive environment? Just curious if you're seeing differences geographically, product categories or anything else that you can help us?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, Rupesh, I don't think so. I think we're all seeing same thing. It's hypercompetitive at the shelf. I think from what we read is the same thing you read, the retailers are feeling the same pinch in terms of their margin structure. Certainly, some of the retailers are talking about a reduction in basket size and obviously, that same pressure ultimately finds our way to us. So the one side of it is misery loves company; the other side of it is, the tide has to rise at some point.

And so going back to some of the statements that both Mike and I made in our commentary, I think we have a fair amount of the uncertainty built into our guidance but we feel pretty comfortable with the momentum that we have based upon the acquisitions that we've made, some of the excitement around UNFI Next for emerging brands, among other things. And so the long answer is, no, I don't see anything else out there that hasn't already been discussed.

Rupesh Parikh - *Oppenheimer & Co. - Analyst*

Okay. So from your perspective, if you look at the natural/organic category, it seems that is still holding up well so would you say, from your perspective, the demand for natural/organic products still remain pretty consistent with what we've seen in recent years?



Steve Spinner - *United Natural Foods Inc. - President & CEO*

I haven't -- certainly haven't seen the overall numbers for 2016. I think that this has obviously been happening for some time. There's still considerable demand for the product across center store and perimeter. It's just being disbursed over a much wider berth, so many, many, many more outlets to buy the same product.

Rupesh Parikh - *Oppenheimer & Co. - Analyst*

Okay, great. One last question for me. Just to help us better understand the impact of acquisitions this year, is there a way to frame how you guys are thinking about the EBITDA or EPS contribution related to the FY16 acquisitions?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

2016 or 2017, Rupesh?

Rupesh Parikh - *Oppenheimer & Co. - Analyst*

For 2017, so as we're looking at your guidance this year, what that contribution is from the acquisitions on the EBITDA and EPS line?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, there's certainly, so let's take EPS first. We didn't give specific guidance related to the acquisitions on the EPS line. They are definitely accretive to the results for the year. On the EBITDA margin, they are relatively neutral to our overall business in terms of their contribution from an EBITDA margin standpoint for FY17. So the gross margins are better but they come with higher expenses because these are higher service, higher touch businesses and -- but when you get down to EBITDA margin, they're very similar.

Rupesh Parikh - *Oppenheimer & Co. - Analyst*

Okay, thank you for all of the color.

Operator

Thank you. Our next question comes from Eric Larson from Buckingham Research Group.

Eric Larson - *Buckingham Research Group - Analyst*

Yes, hi, everyone. Thanks for taking my question. Two of them. Can you give us a little bit more of a breakdown of your \$255 million. Well, I guess it was \$335 million of free cash flow for the year but obviously, we can figure out the capital spending. What was the contribution from improved working capital and can you break that down a little for us?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, thanks, Eric. We had terrific performance this year, as you've seen on our free cash flow. As you mentioned, CapEx certainly is a component of that; you can see that it's not the lion's share of it. We also had good cash off of our business that contributed but I think, overall, as you look at it, its improvement in inventory and improvement in day sales outstanding that lead to the largest gains for us in the quarter. Over the year, we've

made improvements across all of our components of working capital and we will continue to try to work those areas for improvement going forward.

Eric Larson - *Buckingham Research Group - Analyst*

In your \$120 million to \$150 million, would that be continuation of all of those? Obviously, your CapEx is going to consume a little bit more capital next year, a little more cash. It -- how does the breakdown look for 2017 to get to that \$120 million to \$150 million guidance?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, you said it. The CapEx is up slightly and we feel confident in that range of \$120 million to \$150 million. We'll continue to work the working capital for improvement and I can tell you that, that range encompasses the second highest free cash flow year in Company history if we were to deliver that. So while it is lower than what we delivered in FY16 and FY16 was the highest, by quite a distance, we still believe it's a good cash flow for next year.

Eric Larson - *Buckingham Research Group - Analyst*

Okay, and then at the end of your fiscal year last year, you said that it was at least two years and maybe three before you need another distribution facility? I think maybe you were talking greenfield but maybe also brown field. Will it be FY18 before you see any meaningful pick-up in CapEx to -- for capacity needs?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

We clearly have not articulated guidance outside of 2017 so I want to be careful that we don't give multi-year guidance. We just acquired a couple of new buildings in Nor-Cal, in Howell, which is in Edison, New Jersey, and Richburg, South Carolina, so we have a lot of focus on getting those two buildings into the UNFI network. They have some expansion capability which would serve us really well in that Mid-Atlantic corridor which we will certainly need as our business grows but I don't anticipate having a major new building in the next 18 months or so unless, of course, there was a significant reason to do it.

Sean Griffin - *United Natural Foods Inc. - COO*

Let me also -- Eric, if I may, this is Sean. When we build a distribution center of the type that we have built here at UNFI over the last five years or so, these buildings are built to flex so as an example, in Racine, Wisconsin, we have a 450,000 square foot Phase I building and is delivering the returns that we would expect. That building can expand by another 300,000 square feet, in any storage or compartment, we need it whether it's chilled, frozen or dry.

And we can do that at a very low cost versus a green or brownfield new building and from a time perspective, in a very expeditious manner, so as you know, we've got several buildings now over the last five years that we've built in that fashion so we can move quite quickly if we need to, at an economical spend.

Eric Larson - *Buckingham Research Group - Analyst*

Okay, great. Thanks for that and then my final question. It's related to your guidance. First of all, in your sales guidance for the year, of 11% -- which is, I'll make it simple, 11% to 13%, how much of that is acquisition revenue? What would be kind of a organic -- how would that break down organically versus acquired sales?



Sean Griffin - *United Natural Foods Inc. - COO*

Yes, Eric, there's a -- I don't think we broke that out in our guidance but so first of all, the guidance is 11.3% to 13.3% in the year, and as I recall, it was 7 or 8 percentage points that comes from acquisitions.

Eric Larson - *Buckingham Research Group - Analyst*

Okay, thanks. And then the final question. I'm sorry I'm asking so many here. Your EPS guidance of \$2.53 to \$2.63, if you look at your adjusted number of \$2.59 for the year, it's -- you're about the middle of your adjusted number. In your GAAP numbers, in your GAAP EPS guidance number, are there any anticipated adjusted -- expenses that would be adjusted for that so that your adjusted number would have growth on top of your \$2.59?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Thank you, Eric, no. Unlike last year, we didn't -- we're not providing any guidance about restructuring going into the year.

Eric Larson - *Buckingham Research Group - Analyst*

Okay, thanks everyone. Appreciate it.

Operator

Thank you. Our next question comes from Zack Fadem from Wells Fargo.

Zack Fadem - *Wells Fargo Securities - Analyst*

Hi, good afternoon guys. I just want to follow-up a little bit on the last question. So with your FY17 guidance implying about 5% to 6% growth ex-M&A, can you talk about some of the organic growth drivers there? And just given the challenging environment from any of your customers, can you talk about what you're seeing? And what gives you confidence that you can get to that 5% to 6%, and perhaps you can talk a little more about the impact of deflation and whether there are any new customer wins embedded in the guidance?

Sean Griffin - *United Natural Foods Inc. - COO*

Yes, well, we don't embed customer wins in our guidance unless we know we have them, right? So if the contract is signed, then we put it in our guidance. If the contract is not signed, then we don't. We do have a, what I would call a vibrant kind of new customer pipeline that we're working on all the time. I think the thing that I'm most excited about is the reorganized sales force and as an example, up until August, we had a sales associate from Albert's calling on a customer.

Tony's calling on a customer, from UNFI calling on a customer, from Select Nutrition calling on a customer, sometimes from eCommerce, sometimes from food service, so it is possible that up until August, we could have had four different sales associates calling on the same customer. And in August, we reorganized the team into one singular salesforce.

So now one person is responsible for the entirety of UNFI's product offering in each customer so we're really hopeful that, that will bring us some opportunity that we have not experienced before. So I think that is the single largest driver of how I would view our 2017 plan, other than, like I said earlier, the dynamics that the customers that we hope to do business with.



Zack Fadem - Wells Fargo Securities - Analyst

Okay, and also, can you update us on the promotional environment, just given recent competition across the grocery space? I'm curious what you're seeing in terms of trade spend or list price reductions for a lot of the center store and also perishable products? And can you also talk about just the impact on your business of things like forward buying and then pricing with your customers?

Steve Spinner - United Natural Foods Inc. - President & CEO

Yes, Zack, I'll take a cut at that. So we've been seeing headwinds year over year from reduced consumer promotion activity. It was a stronger headwind in Q1 and Q2 and then as we talked about last quarter, we were seeing headwinds in Q3 year over year but it had moderated some in Q3. As we go to Q4, we've still got year-over-year headwinds but they have moderated some versus the first half of the year so that continuation is there.

On the forward buying side, as Sean pointed out earlier, we do better on forward buying in times of inflation because there are more instances of price advances which allow us to take advantage of a forward-buy at the lower price and own that inventory at the lower price while the price advance goes into play. So an inflation number is an aggregation of thousands of instances of price increase or decrease and of course, when we're flat, we just have less instances of increase that we can take advantage of.

Zack Fadem - Wells Fargo Securities - Analyst

So just to confirm, so in periods of deflation, if you're holding that inventory you buy too long, is it possible that you take a loss when you sell it through?

Steve Spinner - United Natural Foods Inc. - President & CEO

Well, I don't know about taking losses when you sell it through but the reverse certainly does happen in a deflationary time. The good news for us is, as we pointed out, that deflation is happening across our fresh business and that's business that we don't hold inventory for nearly as long so the impact is -- minimizes the result.

Zack Fadem - Wells Fargo Securities - Analyst

Got it. Thanks so much. Appreciate the color.

Operator

Thank you. I have time for one last question. Our last question comes from Robby Ohmes from Bank of America.

Robby Ohmes - BofA Merrill Lynch - Analyst

Hey guys. Thanks for taking my question. Mike, I wanted to just clarify, the 7% to 8% from already announced acquisitions, sorry, the 7% to 8% from acquisitions, is that the already announced or for FY17, does that include other acquisitions that you haven't announced?

Mike Zechmeister - *United Natural Foods Inc. - CFO*

Thanks, Robby, for asking the questions and for the clarification. It does not include any acquisitions that have not been announced so it is the continuation of the acquisitions we made in FY16 and it does also include the addition of Gourmet Guru, which was acquired after the end of the fiscal year in our early in our Q1.

Robby Ohmes - *BofA Merrill Lynch - Analyst*

Got it. That's helpful and just one other quick follow-up. The fuel surcharges outlook, so just I just want to clarify so your diesel costs were up but the national was down so is -- are fuel, you're not getting any benefit from fuel surcharges at this point in time; is that right?

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Yes, it's a -- you have to look at quarter over quarter versus year over year and clearly year over year, we're seeing -- we've lost quite a bit of surcharge. Quarter over quarter, the fuel prices actually went up quite a bit. Market price was up 23% so quarter over quarter, quarter four over quarter three. While surcharges haven't kicked in, we certainly were paying a higher price so a bit different when you compare year over year versus quarter over quarter. As you look forward, we are not in the business of forecasting oil or diesel prices so we use market expectations in our plan.

Robby Ohmes - *BofA Merrill Lynch - Analyst*

Got it. That's very helpful. Thanks so much.

Operator

Thank you.

Steve Spinner - *United Natural Foods Inc. - President & CEO*

Thanks again for joining us this afternoon. We're focused on FY17. We look forward to discussing our first quarter results later with -- later this year. Thank you for your continued interest in UNFI and have a great night.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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