

United Natural Foods, Inc. (NYSE:UNFI)



Trading Statistics (USD)

Market Cap (bb)	1.55	LTM EPS	2.00	Update Date	16 Feb 2021
Current Price	27.62	LTM P/E	13.8	Recommendation	BUY
52 Wk L - H	5.00 - 32.18	EV / EBITDA	7.85	Price Target	NONE

Business Description

- Largest wholesale distributor in the US and Canada with over 60 distribution centers
- distributes over 275,000 natural, organic and conventional products to more than 30,000 customers including natural product superstores, independent retailers, conventional supermarket chains, ecommerce retailers and food service industry
- Customers include Whole Foods (Amazon), Wegmans, The Fresh Market and Kroger
- Acquisition of competitor Supervalu in 2018 - Retail business

Financial Summary

	FY17	FY18	FY19	FY20	TTM
Revenue (mm)	9,274	10,227	22,307	26,514	27,167
EBITDA (mm)	317	314	66	115	594
Margins	3.4%	3.1%	0.3%	0.4%	2.2%
Net Income (mm)	130	163	-285	-274	109
Margins	1.4%	1.6%	-1.3%	-1.0%	0.4%

Investment Thesis

Business Description:

- \$140 billion potential market with currently \$25 billion market and \$38 billion existing customer opportunity
- Major Competitors: SpartanNash (NASDAQ:SPTN), C&S Wholesales Groger and Kehe
- Minor competitors (serves mostly to restaurants, schools and other small units): Sysco (NYSE:SY) and US Food Holdings (NYSE:USFD)
- Over 60 distribution centers (total 28.8 million sq ft) vs 19 for SPTN (8.2 million sq ft)
- Diversified with moat in fast growing natural and organic

	UNFI	C&S Wholesales Groger	SpartanNash	KeHE	Category Growth
Conventional	✓	✓	✓		12.4%
Natural	✓			✓	16.3%
Specialty	✓			✓	10.0%
Services	✓				
Protein / Produce	✓	✓	✓		16.0%
Deli	✓				1.9%
Private Brands > \$1B	✓				12.3%
eComm	✓	✓	✓	✓	40%

Natural	Conventional	Premium	Ethnic	Value

- Customers:
 - Chains
 - Independent retailers
 - supernatural
 - retail
- Largest customer: Whole Foods with about 18% of revenues in 2020
- 6 product categories:
 - Grocery and general merchandise
 - Produce

- Perishables and frozen foods
- Nutritional supplements and sports nutrition
- Bulk and food service products
- Personal care items
- 2 business segments
 - Wholesale
 - Retail

Catalysts:

- Changing consumer habits into natural and organic
- Deal with Amazon until 2025 for exclusive distribution to Whole Foods
- Divestiture of retail business to raise capital for debt repayment
- Pandemic favors business
- Leased trucks - no fear of depreciation of assets or electrification

Risks:

- Took high debt for Supervalu acquisition with high interest payments
- Depends on derivatives to handle debt repayments at lower interest rates
- Could lose largest customer if Amazon decides not to renew contract in 2025

Financial Analysis:

- Revenues of \$27.2 billion in TTM up from 26.5 billion in FY20 (ended in July 2020) and \$8.4 billion in FY16
- 91% of revenues from wholesale and 9% from retail
- Wholesale revenue growth of 18% from FY19 to FY20
- Operating income of 403 million in TTM vs \$333 million for FY20
- 87% of Adjusted EBITDA from wholesale and 13% from retail
- Net income of \$109 million in TTM vs net loss of \$274 million for FY20
- Net loss in FY19 and FY20 mostly because of impairment of goodwill of \$293 million and \$495 million respectively, after the Supervalu acquisition
- FCF of \$365 million vs \$284 million for FY20 (excluding \$102 million in divestitures from sales of retail stores)
- Owner's earnings (including divestitures as they offset interest payments to bondholders) of \$351 million in TTM vs \$382 million in FY20
- Balance Sheet
 - Total assets: \$7.78 billion ; total liabilities: \$6.63 billion; book value: \$1.15 billion
 - Cash: \$49 million, debts: \$2.62 billion, current assets: \$3.94 million, current liabilities: \$2.37 billion

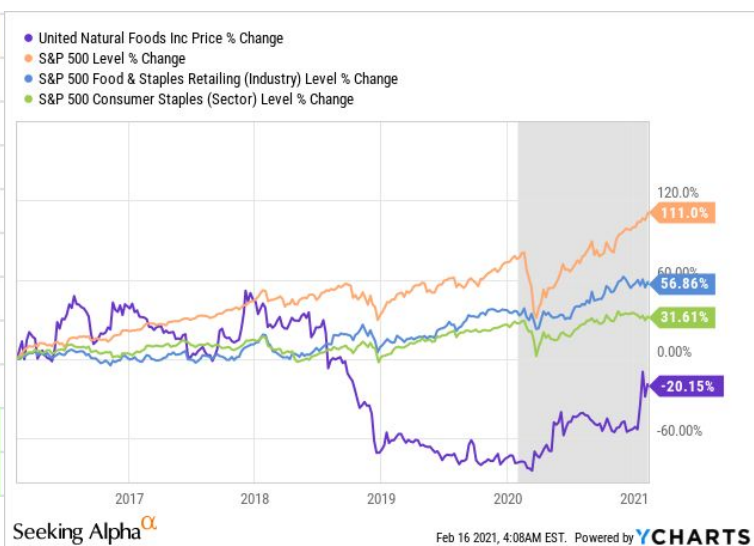
<i>(in thousands)</i>	Average Interest Rate at August 1, 2020	Fiscal Maturity Year	August 1, 2020	August 3, 2019
Term Loan Facility	4.41%	2026	\$ 1,773,000	\$ 1,864,900
ABL Credit Facility	1.58%	2024	756,712	1,080,000
Other secured loans	5.19%	2024-2025	49,268	57,649
Debt issuance costs, net			(45,846)	(54,891)
Original issue discount on debt			(35,508)	(41,175)
Long-term debt, including current portion			2,497,626	2,906,483
Less: current portion of long-term debt			(70,632)	(87,433)
Long-term debt			<u>\$ 2,426,994</u>	<u>\$ 2,819,050</u>

Valuations

- My personal Biases:
 - Bullish on industry
 - Belief in ability to repay debt with divestitures
 - Thinking that Amazon won't choose to have their own distribution system so as not to attract antitrust regulators and keep using UNFI
- Assumptions for base case:
 - Use Discounted Owner's earnings to calculate intrinsic value
 - \$100 million in divestitures in 2021 and 2022 each
 - Revenue growth of 10% per year
 - Profit margins of 1.5% in the long-term (2021 and 2022 lower with synergy costs)
 - Depreciations of \$300 million per year and Capex of \$200 million per year
 - All of owner's earnings used to repay debt
 - Discount Rate of 18% till 2026
 - Terminal Growth rate of 2%

	2015	2016	2017	2018	2019	2020	TTM	2021	2022	2023	2024	2025	2026
Revenues	\$ 8,185	\$ 8,470	\$ 9,274	\$ 10,227	\$ 22,307	\$ 26,514	\$ 27,167	\$ 27,400	\$ 30,140	\$ 33,154	\$ 36,469	\$ 40,116	\$ 44,128
Net Income	\$ 139	\$ 126	\$ 130	\$ 163	\$ (286)	\$ (254)	\$ 132	\$ 184	\$ 300	\$ 497	\$ 547	\$ 602	\$ 662
Depreciation	\$ 64	\$ 71	\$ 86	\$ 88	\$ 248	\$ 282	\$ 284	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300
Capex	\$ (129)	\$ (41)	\$ (56)	\$ (45)	\$ (228)	\$ (173)	\$ (169)	\$ (200)	\$ (200)	\$ (200)	\$ (200)	\$ (200)	\$ (200)
Goodwill impairment	\$ -	\$ -	\$ -	\$ 11	\$ 293	\$ 425	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Owner's Earnings	\$ 74	\$ 156	\$ 160	\$ 217	\$ 73	\$ 382	\$ 351	\$ 384	\$ 500	\$ 597	\$ 647	\$ 702	\$ 762
FCF	\$ (80)	\$ 255	\$ 217	\$ 64	\$ 56	\$ 284	\$ 365	\$ 284	\$ 400	\$ 597	\$ 647	\$ 702	\$ 762
Divestitures	\$ -	\$ 8	\$ 3	\$ (7)	\$ 46	\$ 102	\$ 104	\$ 100	\$ 100	\$ -	\$ -	\$ -	\$ -
Net Issuance of Debt	\$ 93	\$ 58	\$ (215)	\$ (26)	\$ 2,039	\$ (462)	\$ (502)	\$ (384)	\$ (500)	\$ (597)	\$ (647)	\$ (333)	\$ (160)
Interest Expense	\$ (14)	\$ (15)	\$ (17)	\$ (16)	\$ (181)	\$ (192)	\$ (211)	\$ 137	\$ 118	\$ 118	\$ 93	\$ 100	\$ 18
Debt Due (as of 2020)								\$ 72	\$ 14	\$ 14	\$ 757	\$ 18	\$ 1,683
Total Debt	\$ 536	\$ 588	\$ 373	\$ 309	\$ 2,819	\$ 2,427	\$ 2,621	\$ 2,237	\$ 1,737	\$ 1,140	\$ 493	\$ 160	\$ -

	Owner's Earnings	Discounted OE
TTM	\$ 351	
2021	\$ 384	\$ 384
2022	\$ 500	\$ 424
2023	\$ 597	\$ 429
2024	\$ 647	\$ 394
2025	\$ 702	\$ 362
2026	\$ 762	\$ 333
Terminal Value		\$ 2,081
Intrinsic Value		\$ 4,407
Per Share		\$ 79



- Bull case with extra 10% extra revenues in 2026 compared to base
- Bear case (loss of Whole Foods as customer) with 30% less revenues in 2026 compared to base
- Shares outstanding grow from 56 million to 70 million

		P/OE Exit Multiples					
2026 OE/share		X1	X3	X5	X10	X15	
Bear	\$ 7.62	\$ 7.62	\$ 22.86	\$ 38.10	\$ 76.20	\$ 114.30	
Base	\$ 10.88	\$ 10.88	\$ 32.64	\$ 54.40	\$ 108.80	\$ 163.20	
Bull	\$ 11.97	\$ 11.97	\$ 35.91	\$ 59.85	\$ 119.70	\$ 179.55	
Returns		-74%	13%	88%	275%	519%	
CAGR		-23.5%	2.4%	13.4%	30.3%	44.0%	
Probability		10%	20%	40%	20%	10%	
Expectation	14%	-2%	0%	5%	6%	4%	

Conclusion

- Undervalued even with 50% margin of safety
- 14% expected returns per year
- Debt risk can be offset by divestitures or generation of cash from operations
- Moderate risk but high reward potential, BUY rating at current price