



## A CUT ABOVE

**BEST IDEA: LONG U.S. FOODS (USFD)**

January 19, 2017

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**QA@HEDGEYE.COM**

*\*ANSWERED AT THE END OF THE CALL*

# HEDGEYE CONSUMER STAPLES INVESTMENT IDEAS SUMMARY

## LONG LIST

1) <b>WFM</b>	Whole Foods Market
2) <b>COST</b>	Costco Wholesale
3) <b>USFD</b>	US Foods
4) <b>GIS</b>	General Mills
5) <b>PF</b>	Pinnacle Foods
6) <b>HRL</b>	Hormel

## TRADE TREND TAIL

-	✓	✓
-	✓	✓
-	✓	✓
-	✓	✓
-	✓	✓
-	✓	✓

## LONG BENCH

<b>PEP</b>	PepsiCo
<b>CAG</b>	ConAgra Foods
<b>SJM</b>	J.M. Smucker Co.
<b>TWNK</b>	Hostess Brands

## SHORT LIST

1) <b>HAIN</b>	Hain Celestial
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## TRADE TREND TAIL

X	X	X
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## SHORT BENCH

<b>NUS</b>	Nu Skin
<b>KR</b>	Kroger

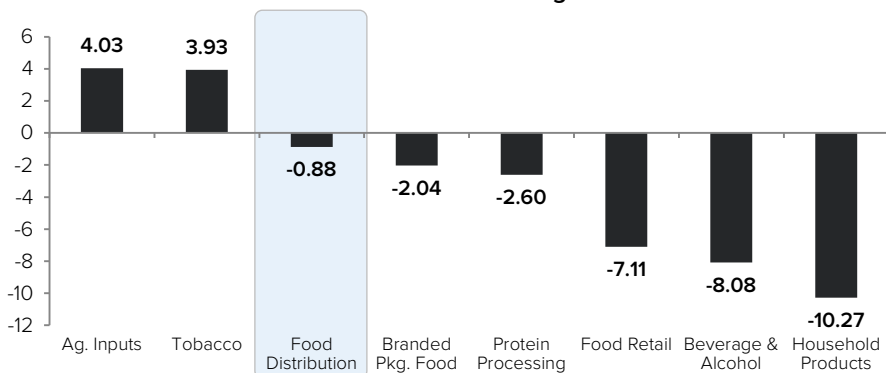
Bench = timing is not right, or research is in progress.



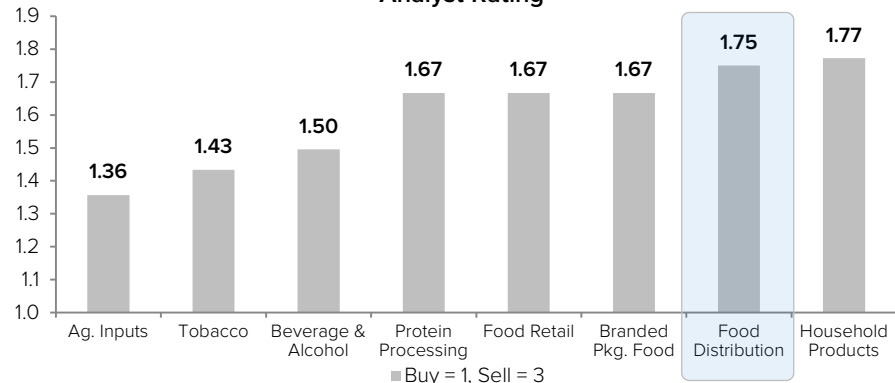
## CONSUMER STAPLES MACRO TRACKER

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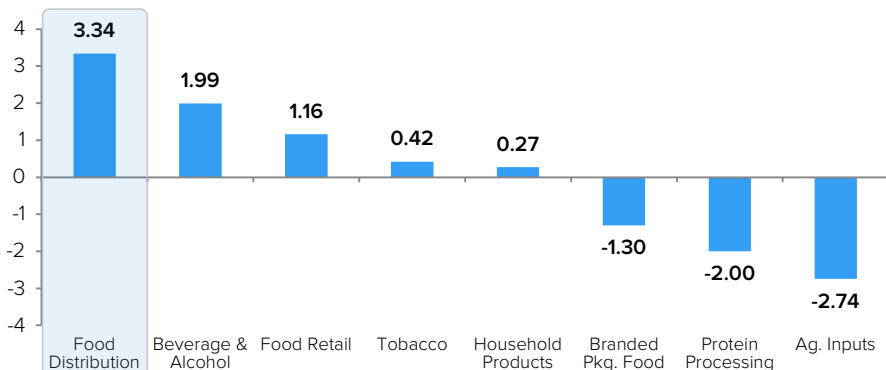
## 6 Month Price Change



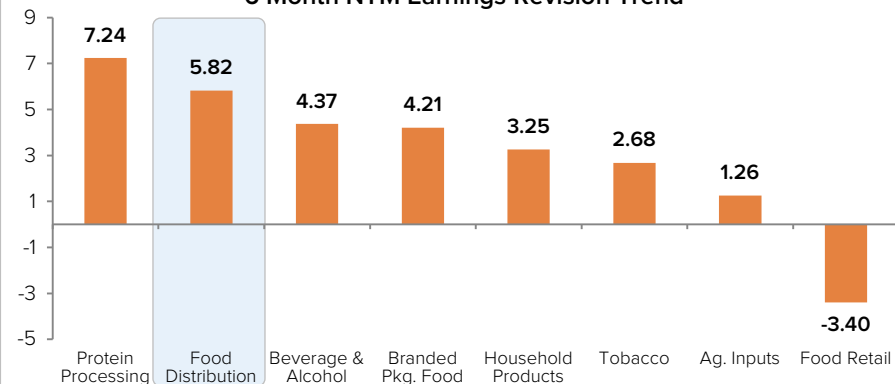
## Analyst Rating



## 6 Month NTM Revenue Revision Trend



## 6 Month NTM Earnings Revision Trend



# MACRO AND POLITICAL IMPLICATIONS

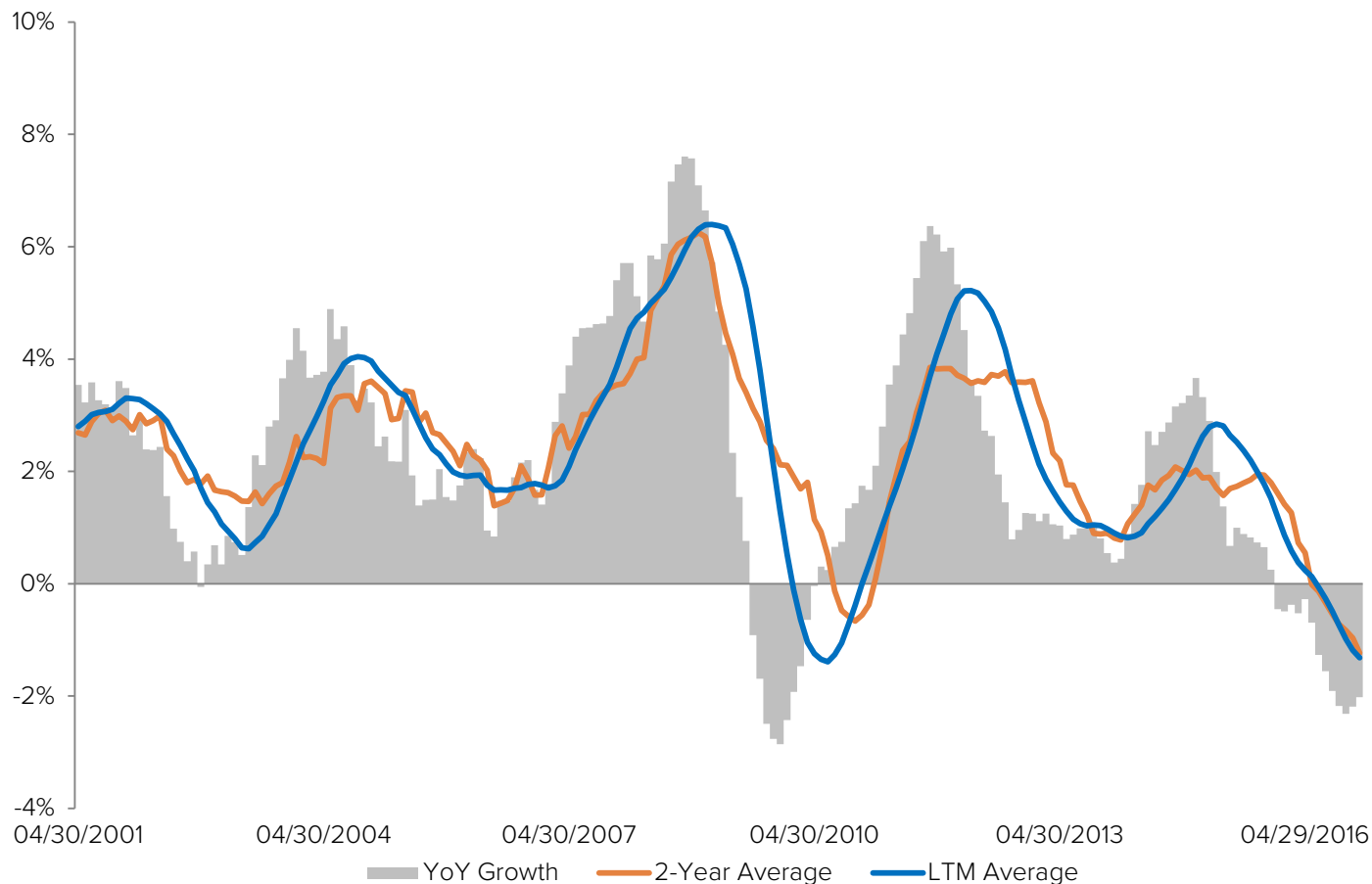
## Reflation Trade

- The reflation trade continues to take shape as some major commodities have begun to form a bottom, while others continue their downward trajectory.
- We have heard from a number of companies that point to the middle of 2017 as a turning point, given fundamentals and easier comparisons.
  - USFD 3Q16, then CFO Fareed Khan, “We expect a deflation environment to continue through Q4 and into the early part of next year. It's been very volatile, and frankly, hard to predict. But we don't see a recovery coming back anytime soon.”
- Last week we got December PPI results which showed sequential improvement in PPI – Finished Consumer Foods.
- And just yesterday we got CPI data which showed continued improvement in the gap between FAH and FAFH.
- The reflation trade is well underway and our macro team expects price growth to continue into 2017.

## The New Administration

- **Trump trade**
  - Since the election, food distributors that we follow have outperformed the S&P 500 by 2x, with median performance of +10.91%.
- **Tax reform**
  - Corporate tax reform is probably a net positive, lower corporate tax rate would be good, while interest deductibility could be a risk.
- **Andy Puzder**
  - This would be a positive for the restaurant industry given Andy is opposed to \$15 minimum wage given the detrimental effect it would have on operators.
  - Although he would be great for the industry, as recently as Monday (1/16) there were rumors swirling that Andy may be having second thoughts.

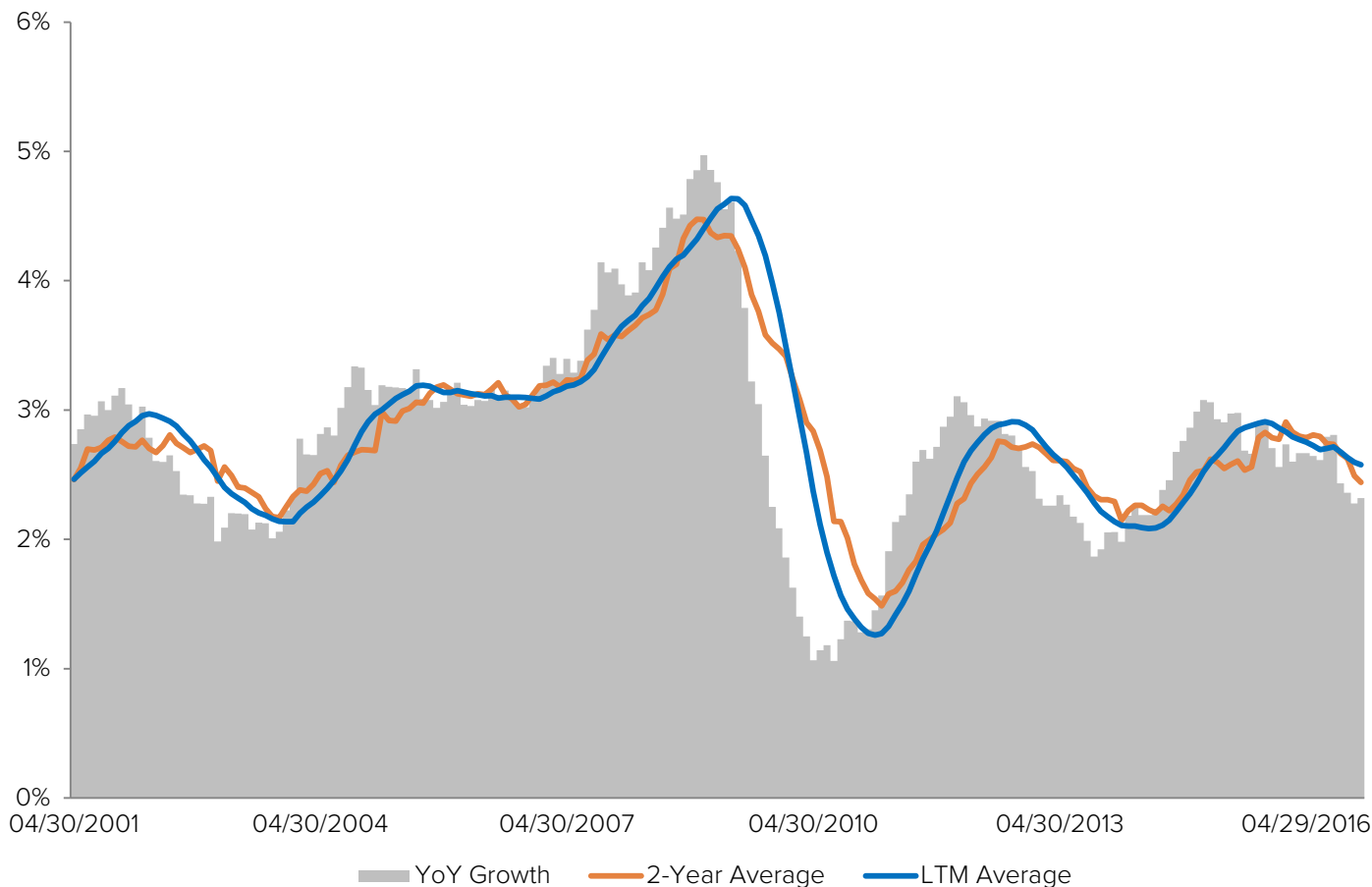
# CPI - FOOD AT HOME (FAH)



- CPI – Food at Home (FAH) remained deflationary but improved by 20bps sequentially to -2.0%; this marks the second consecutive improvement in YoY growth.
- Going forward, we expect the improvement in FAH to continue, which, to a large extent, will be driven by easier comps.
- Other expenses that will be pulling on consumer's wallets include energy, shelter and medical which are handily outpacing food inflation, or better put, deflation.

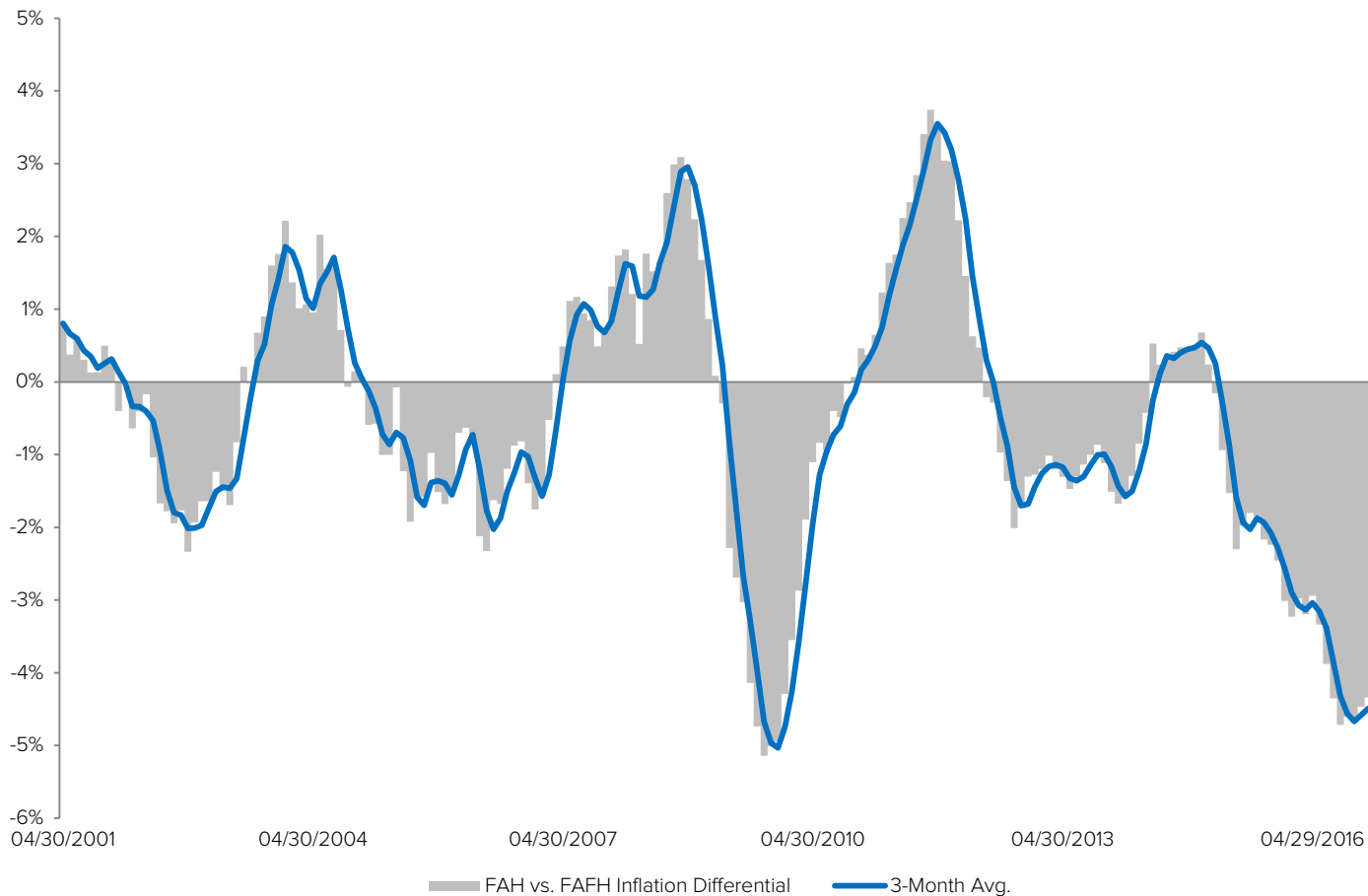


# CPI - FOOD AWAY FROM HOME (FAFH)



- CPI – Food Away From Home (FAFH) YoY growth held flat in December at 2.3%.
- We have seen some aggressive pricing in the restaurant industry begin to roll off and come down to more normalized levels; this is evident in the steady decline of the LTM average line in blue.

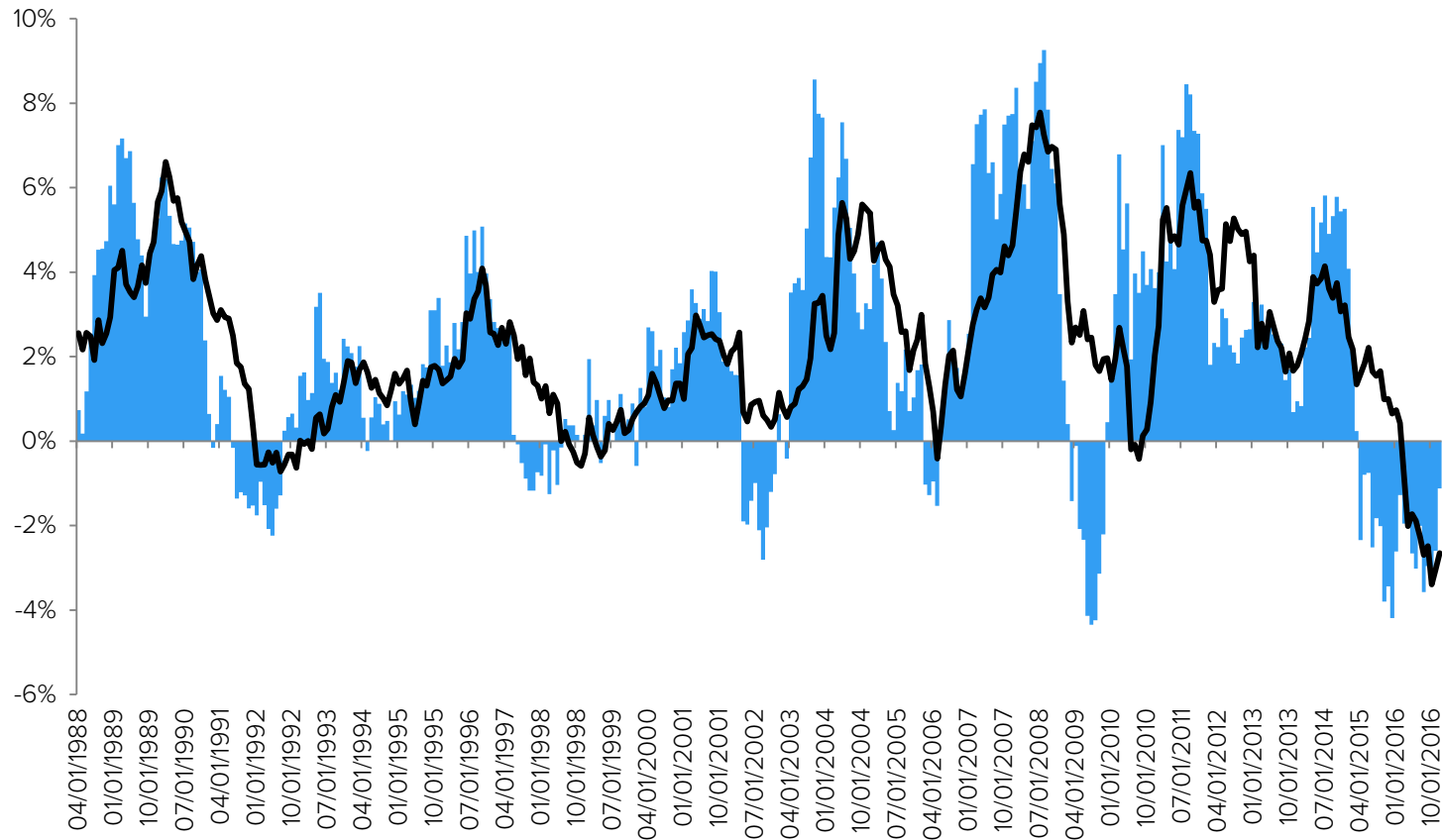
# CPI FAH VS FAFH INFLATION DIFFERENTIAL



- FAH vs. FAFH inflation differential has been a popular excuse for some of the underperformance at large chain restaurants for the last six months.
- December marks the second consecutive month of improvement in this metric.
- The spread between FAH and FAFH narrowed by 20bps to -4.3%, the biggest gap we have had in this cycle is -4.7%, and going back to the great recession it was slightly larger at -5.1% in September 2009.

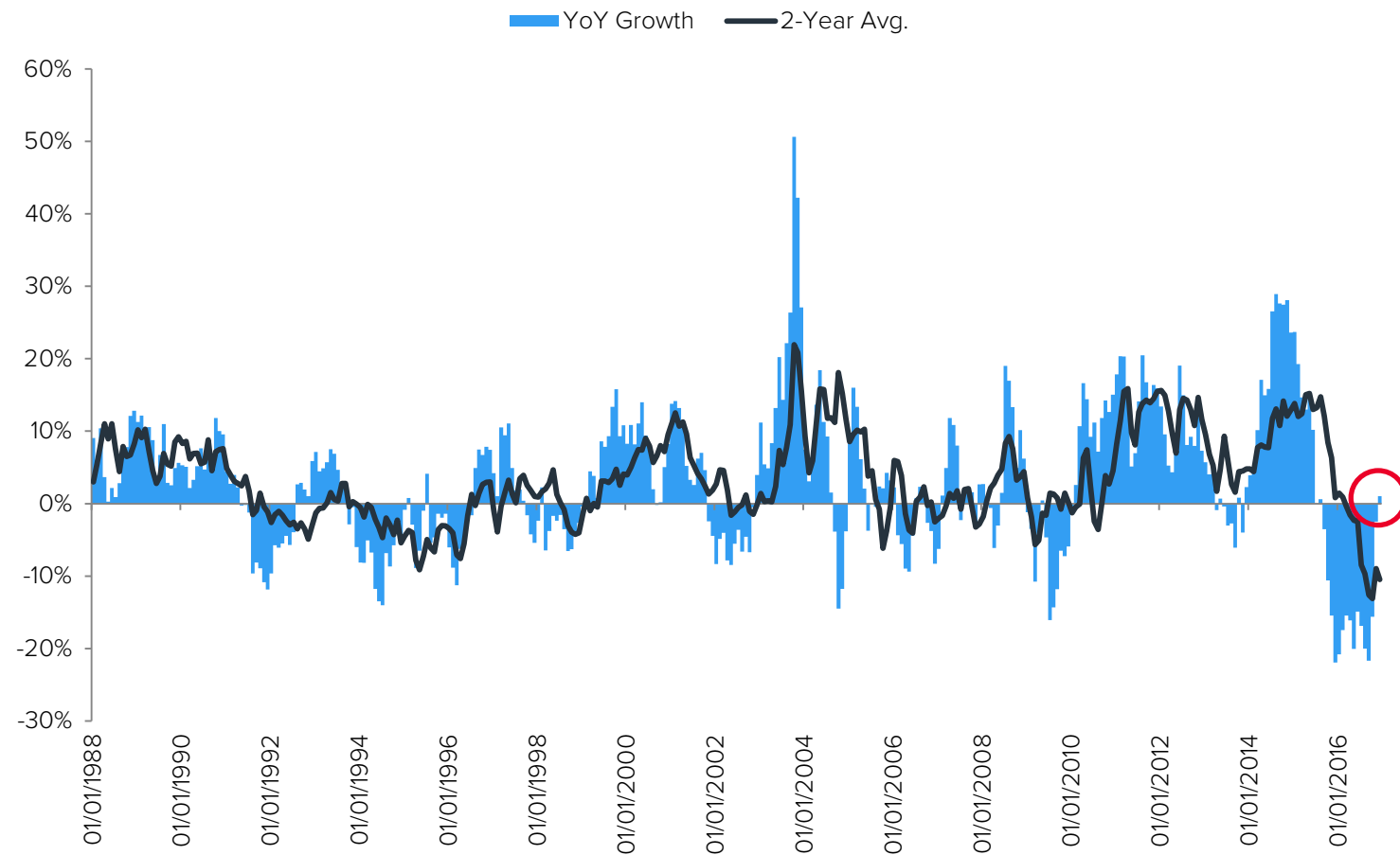
# PPI – FINISHED CONSUMER FOODS

YoY Growth 2-Year Avg.



- December marked the second consecutive month of sequential improvement in YoY growth of PPI – Finished Consumer Foods.
- YoY Growth in December improved to -1.1%, a 148bps improvement versus November.
- Additionally, the two-year average improved 30bps sequentially to -2.7%, as that metric looks to have found its low water mark in October at -3.4%.

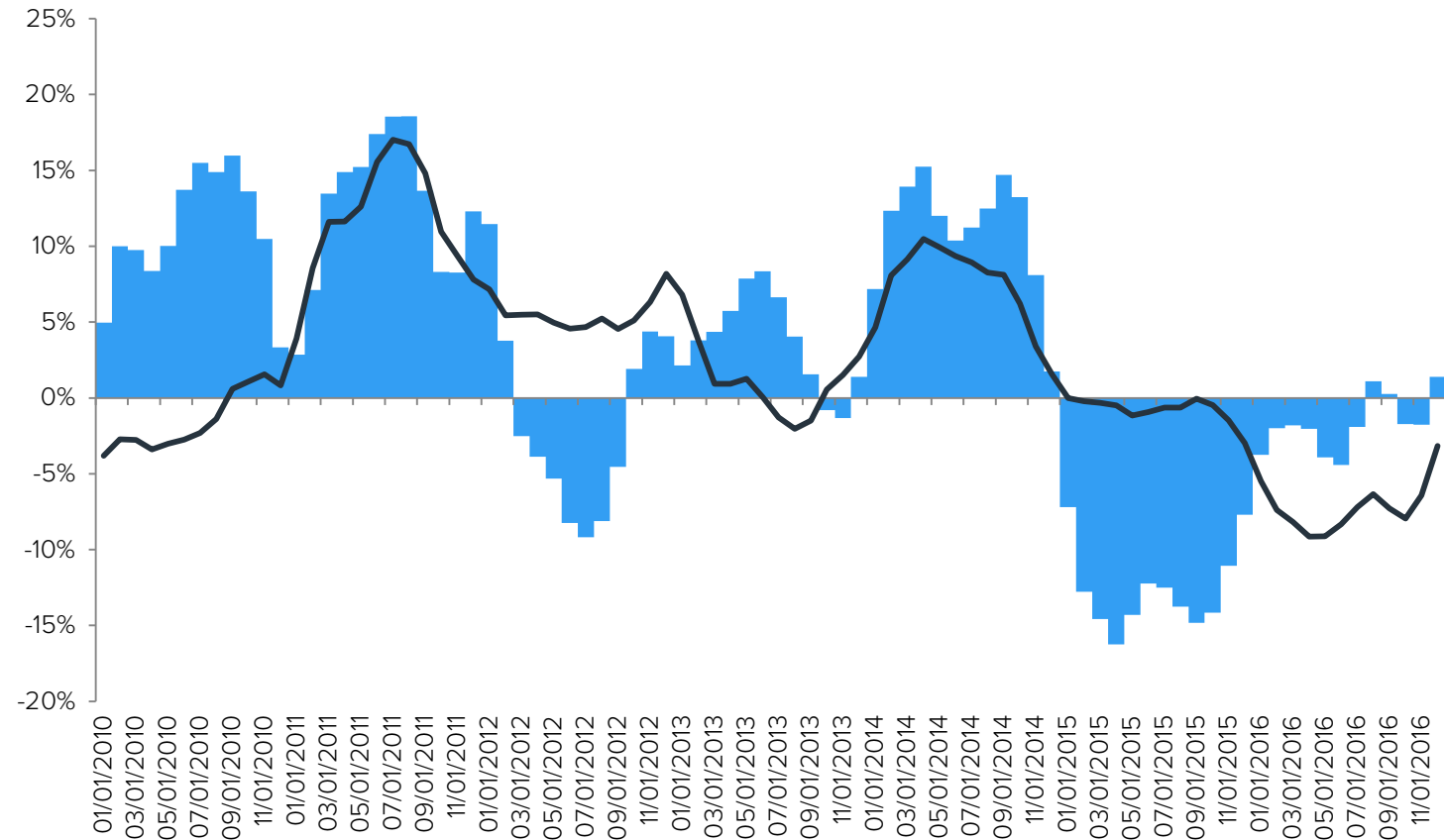
# PPI – BEEF AND VEAL, FRESH OR FROZEN



- We got our first positive reading in PPI – Beef and Veal in 15 months in December.
- This metric grew by 1.0% YoY, a 350bps improvement versus November.
- Although it grew on a one-year basis, the two-year average number actually decelerated 150bps to -10.5%.
- We have another fairly easy comp of -20.8% in January, that should assist the two-year average trend.

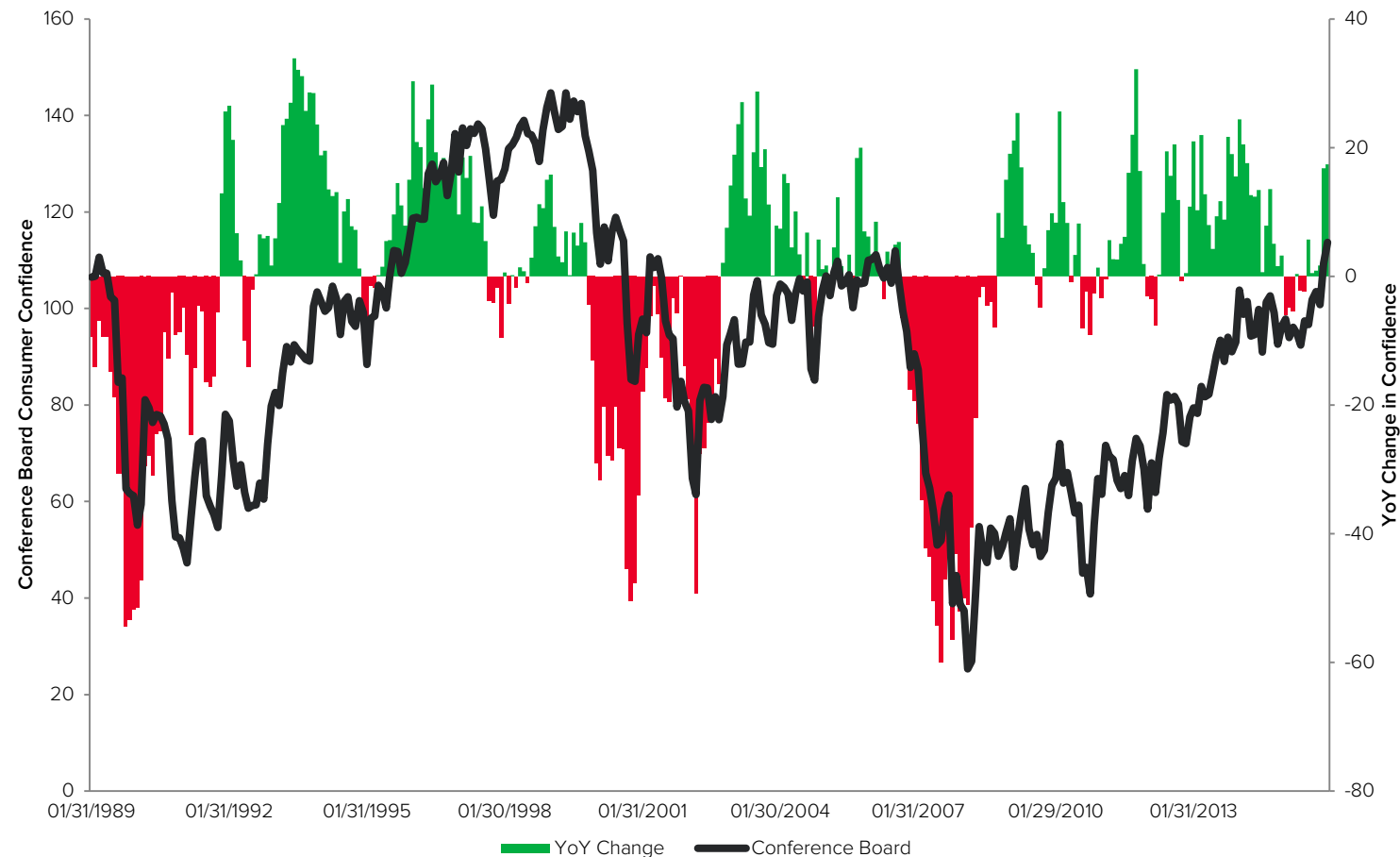
# PPI – DAIRY PRODUCTS

YoY Growth 2-Year Avg.



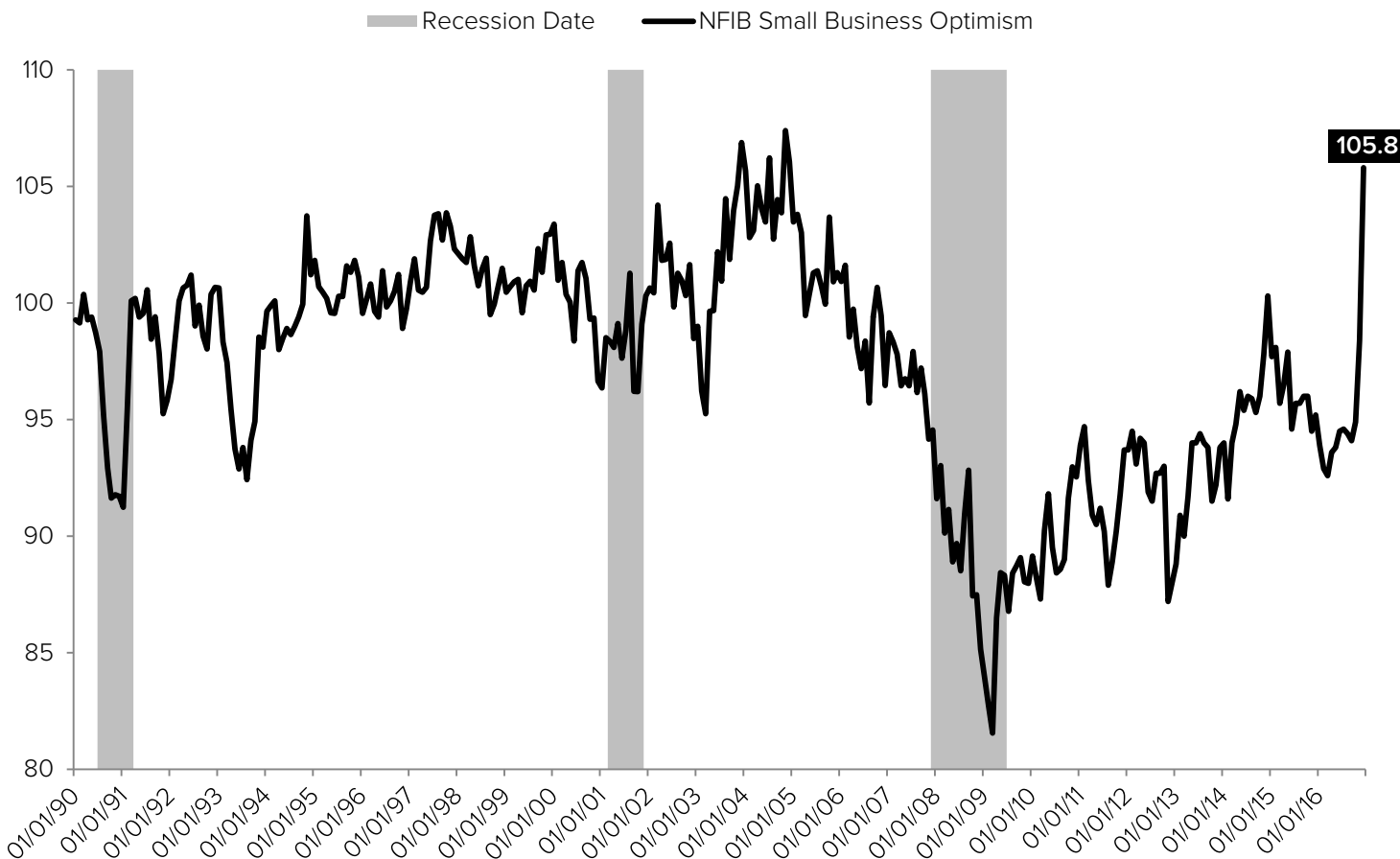
- PPI – Dairy Products has been see-sawing between positive and negative YoY growth for the last five months.
- In December, PPI – Dairy products grew by 1.4% YoY, a 320bps improvement YoY.
- On a two-year basis, the metric is still negative but improved 326bps to -3.2%.

# CONFERENCE BOARD CONSUMER CONFIDENCE



- The post election surge in consumer confidence is being driven by optimism for the economy and job/income prospects.
- Going forward throughout the year consumer confidence will be dictated by the extent of the realization of expected benefits.
- For now, we anticipate this optimism will be 'pre-spent' with a portion going to restaurant spending.

# NFIB SMALL BUSINESS CONFIDENCE ACCELERATING



- Trumphoria is now ubiquitous across all consumer and business series, with almost every measure gapping higher post-election.
- Independent restaurants are small businesses, which in turn is positive news for USFD's and their opportunity to supply that confidence going forward.



**LONG: U.S. FOODS (USFD)**



# KEY POINTS

1

## MARGIN EXPANSION THROUGH MULTIPLE AVENUES

Pruning low margin distribution agreements and growing their private label sales have been two major initiatives to improve the profitability of the Company. Strategic national chain exits occurred from 2Q14 through 2Q16, while at the same time they have been growing the penetration of private brands which have expanded from 30% of sales in 2010 to 33% in 2016. These core initiatives, coupled with further penetration of customers' menus, and technological enhancements to improve USFD operations, as well as those of their customers, are meaningful contributors to the growth in profitability.

2

## GROWTH WITH INDEPENDENTS AND HEALTHCARE SEGMENT

One of USFD's biggest advantages is their positioning within the restaurant industry, dedicating themselves heavily to the independent and regional operators versus large/lower margin national chains. In addition to the profitability difference, the independents are faring better from a sales growth perspective than national chains, making it a stronger customer base. USFD's growth in the healthcare segment is also notable; with the recent signing of a deal with Brookdale Senior Living, they continue to expand in this channel.

3

## DEBT BURDEN IMPROVING, ALLOWING FOR MORE M&A

Pre-IPO net debt/EBITDA was 5.3x, USFD used all of their \$1.1 billion in IPO proceeds to lower their leverage, and have renegotiated many of their terms putting them in a much better financial position. As of the latest quarter they are down to a leverage multiple of 3.8x. Tuck in acquisitions are going to continue to be a major factor for both top line growth and profitability, of which they have done five in roughly the last year with a combined run rate of \$450-\$500 million in net sales. In our opinion a major deal looms in the industry, that will create a more formidable #2.

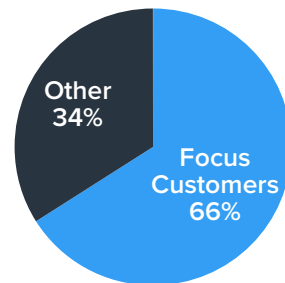
# COMPANY OVERVIEW

## Company Overview

- US Foods is one of only two foodservice distributors with a national footprint in the United States.
  - As of 2015, USFD held a 9% share of this \$268 billion industry
- US Foods was organized as a corporation in Delaware in 1989 (US Foodservice) and traces its roots back over 150 years to a number of heritage companies, of which includes: Monarch Foods (1853), Sexton (1883), PYA (1903), Rykoff (1911), Kraft Foodservice (1976).
- The Company supplies approximately 250,000 customer locations nationwide, and this includes, but is not limited to:
  - Independently owned single and multi-unit restaurant concepts
  - Regional restaurant concepts
  - National restaurant chains
  - Hospital and nursing homes
- USFD provides customers with over 400,000 fresh, frozen, and dry food SKU's, as well as non-food items, sourced from over 5,000 suppliers.
- The Company possesses a network of 62 distribution facilities, 7 stockyards, 3 culinary equipment & supply stores, and a fleet of approximately 6,000 trucks.
  - Currently piloting a "Cash and Carry" distribution format through their "ChefStore" concept.
  - Four ChefStore locations: Charlotte, NC; Oklahoma City, OK; Columbia, SC; and Tempe, AZ.
- In an effort to differentiate the company and reflect a shift in the brand's strategy, they rebranded from "US Foodservice" to "US Foods" in November 2011.

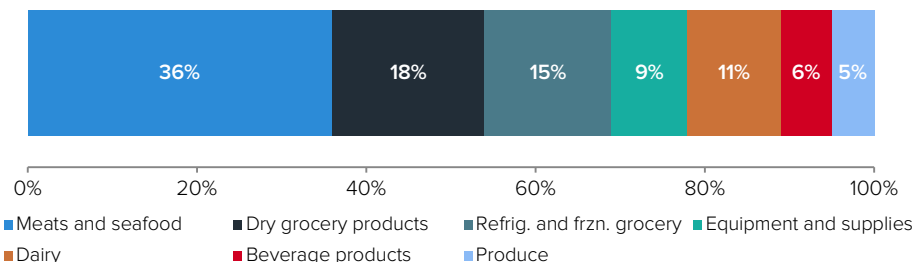
## Sales Breakdown

### By Customer Type



Focus customers include independent restaurants, small & regional chains, and healthcare & hospitality customers.

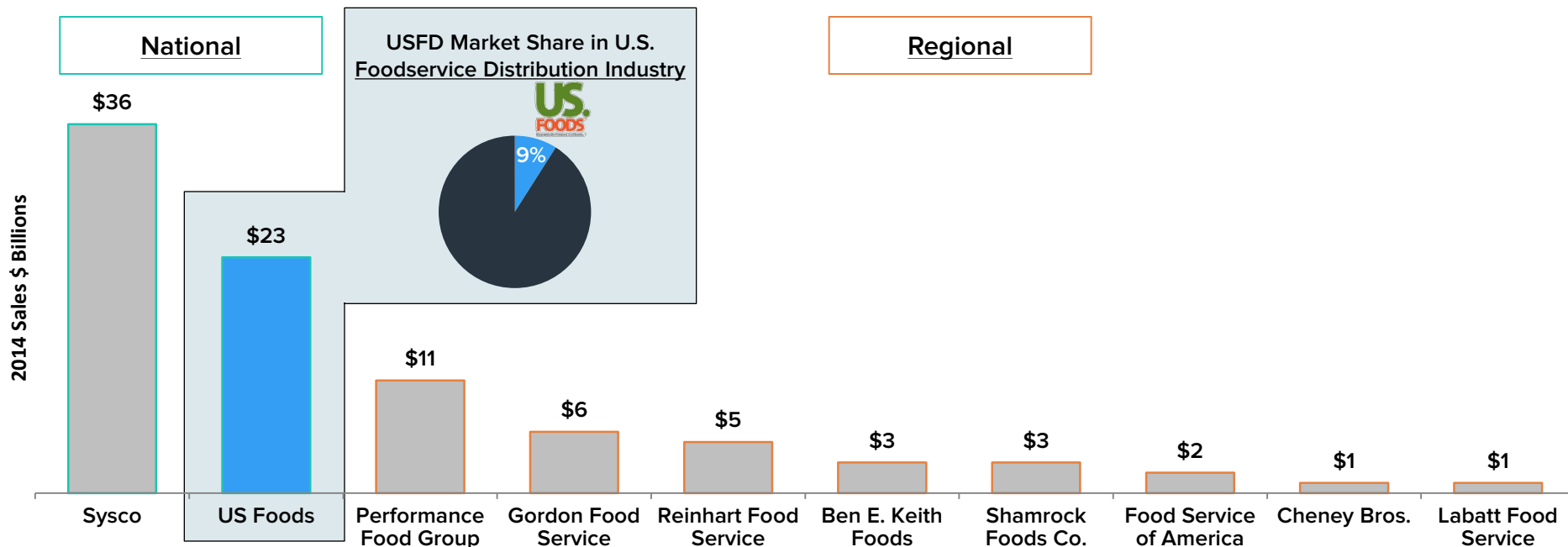
### By Product Category



**2015 Revenue: \$23.1 billion**

# FRAGMENTED INDUSTRY

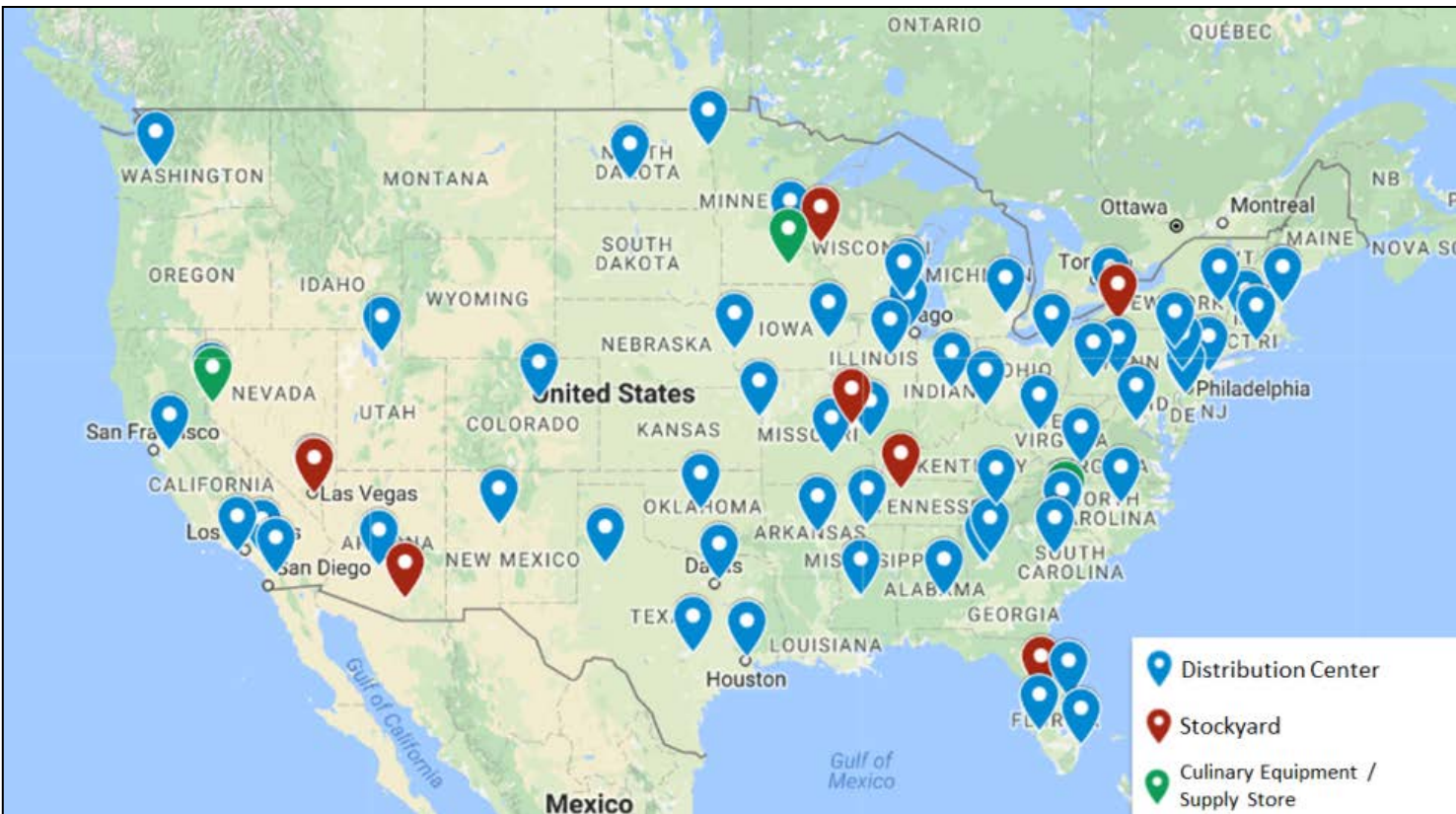
## U.S. Broadline Sales of Top 10 Foodservice Distributors



## ROOM FOR CONSOLIDATION

The foodservice distributor industry is a very fragmented one, with over 15,000 local and regional distributors, cash & carry and club store competitors. There is ample room for consolidation, which USFD has already contributed to on a smaller scale with five deals in roughly the last year, with an estimated net sales run-rate of \$450 million to \$500 million.

# USFD DISTRIBUTION LOCATIONS PROVIDE NATIONAL COVERAGE



- USFD has a strong national footprint, built up by 62 distribution centers, 7 stockyards and 3 culinary/supply stores.

# RECENT MOVING PIECES: 1/12/17 → 1/13/17

## Fareed Khan Out as CFO

- Last week Fareed announced his resignation as the CFO.
- He had been the CFO of USFD since 2013.
- The very next day Kellogg (K) announced that he would be joining them as CFO, effective February 17, 2017. (We consider this a great opportunity for him, and not a knock on USFD.)
- Dirk J. Locascio (internal) will assume the role of CFO. He had been being groomed for this role.

## Two New Board Members

- USFD elected two new independent Board members, effective February 11, 2017.
- **Bob Dutkowsky**, he is currently the CEO of Tech Data Corp. Dutkowsky has 30 years of experience in the IT industry. Bob will bring his deep knowledge of tech distribution and corporate governance to the USFD Board.
- **Andy Pforzheimer** currently serves as Chairman with Barteca Holdings LLC. Andy also serves as the Director of Hickory Tavern, a restaurants group based in Charlotte, NC. Andy will bring extensive restaurant knowledge to the Board.

## Secondary

- On 1/13/2017 USFD filed a \$100 million secondary for holders, Clayton, Dubilier & Rice and Kohlberg Kravis Roberts (KKR)
- Given their combined ownership of roughly 75% of the stock, this news comes as no surprise and we expect this to continue to happen over time.

## Q4 Pre-Release

- Net sales for 4Q16 are expected to be \$5.7 billion.
- Total case volume is expected to grow 4.1% while independent case volume is expected to grow 6.1%.
- Net income will be in the range of \$70 million to \$80 million.
- Adjusted EBITDA is expected to be in the range of \$256 million and \$264 million versus FactSet \$253.8 million.

# MANAGEMENT TEAM

## Management Team



**Pietro Satriano, Chief Executive Officer and President**  
Has served as CEO and President since July 2015. He previously held the role of Chief Merchandising Officer. Prior to joining USFD in 2011, Mr. Satriano was President of LoyaltyOne Canada, the company behind AirMiles, Canada's largest consumer loyalty reward program. Mr. Satriano began his career with BCG (The Boston Consulting Group) and then with the Monitor Company in Milan, Italy.



**Dirk Locascio, Incoming Chief Financial Officer**  
Dirk has served in a variety of finance and accounting roles since he joined in 2009. He currently serves as Senior Vice President, Financial Accounting and Analysis, responsible for oversight of the company's corporate finance and accounting functions. Prior to USFD Dirk worked at United Airlines and in public accounting at Arthur Andersen.

### **Kristin Coleman, General Counsel and Chief Compliance Officer**

Kristin joined USFD on February 1. Prior to joining USFD, Kristin worked for Sears Holdings as the SVP, General Counsel and Corporate Secretary since 2014. Kristin is taking over for Luis Avila who had been serving on an interim basis.

### **Andrew Iacobucci, Chief Merchandising Officer**

Andrew will join the Company as CMO effective January 23. He will oversee category management, procurement, product innovation, food safety and marketing. Prior to joining USFD Andrew served as EVP, Merchandising for Ahold USA. Andrew succeeds Steve Guberman in this role, as Steve will be moving on to EVP, Nationally Managed Business for USFD.

## Board of Directors

**Pietro Satriano, Chief Executive Officer, President, Director** - Has served as CEO and President since July 2015. He previously held the role of Chief Merchandising Officer.

**Court D. Carruthers, Director** - Mr. Carruthers is the principal and founder of CKAL Advisory Partners, where he provides private equity advisory services in the distribution, e-commerce, and supply chain sectors.

**John C. Compton, Chairman** - Mr. Compton has been the Chairman of the Board of Directors since August 2015. He is a 29-year veteran and former President of PepsiCo, Inc., and currently holds the title of Partner at Clayton, Dubilier & Rice, LLC.

**Kenneth A. Giuriceo, Director** - Mr. Giuriceo has been a partner since August 2015 and is currently a financial partner at Clayton, Dubilier & Rice, LLC., a position he has held since 2007.

**John A. Lederer, Director** - Mr. Lederer has been a director since September 2010. From September 2010 until July 2015, Mr. Lederer also served as President and CEO of US Foods. In addition, he was Chairman and CEO of Duane Reade from 2008 to 2010.

**Vishal Patel, Director** - Mr. Patel has been a director since August 2015. Mr. Patel joined Kohlberg Kravis Roberts & Co. L.P. (KKR) in 2010 and is a member of the retail team.

**Richard J. Schnall, Director** - Mr. Schnall has been a director since 2007. He has been a financial partner at Clayton, Dubilier & Rice, LLC since 2001.

**Nate Taylor, Director** - Mr. Taylor has been a director since March 2011. He joined Kohlberg Kravis Roberts & Co. L.P. (KKR) in 2005.

**David M. Tehle, Director** - Mr. Tehle is the former EVP and CFO of Dollar General Corporation, where he served in the senior finance role since 2004, before retiring in 2015.

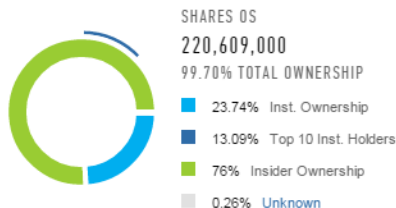
# OWNERSHIP STRUCTURE / IPO TIMELINE

## Ownership Structure

Name	% OS	Position (000)
Clayton Dubilier & Rice (CD&R)	37.77	83,333
Kohlberg Kravis Roberts & Co. L.P.	37.77	83,333
John A. Lederer	0.23	504
Pietro Satriano	0.07	164
Fareed Khan	0.03	72

- In 2007, CD&R and KKR acquired US Foods from Royal Ahold N.V.
- As such significant holders of company stock (~75% ownership), this leaves very little float for the public to trade, which is less than ideal.

### Ownership Statistics



**SHORT INTEREST**    **FLOAT**    **INST. OWNERSHIP**  
 1.9 DAYS / 2.7% FLOAT    24%    98.9% OF FLOAT

31 Dec '16 13F Filing Count    4 (2.58%)  
 30 Sep '16 13F Filing Count    142 (91.61%)  
 Other Filings    9

Detailed Ownership

Data as of: 16 Jan '17

## IPO Timeline

2007

- On May 2, 2007, Clayton, Dubilier & Rice and Kohlberg Kravis Roberts and Co. L.P. announced an agreement to acquire U.S. Foodservice from Royal Ahold N.V., taking the company private
- Funds affiliated with CD&R and KKR are equal partners in the transaction, valued at \$7.1B

2013-2015

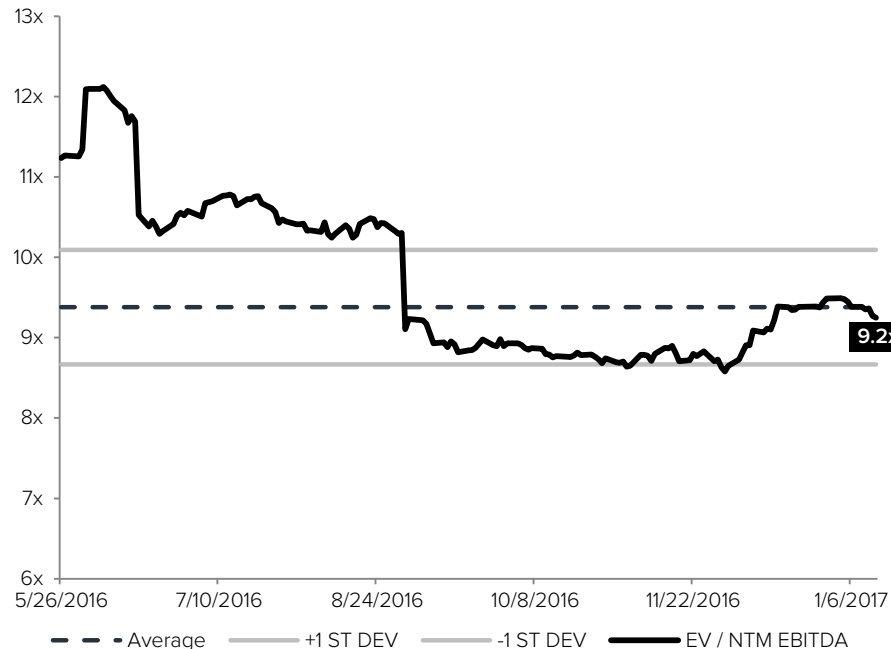
- On December 9, 2013, SYF announced that it would buy US Foods for \$8.2B (\$3.5B in cash and \$4.7bn in debt).
- On June 24, 2015, U.S. Federal Judge Amit Mehta issued an injunction blocking the planned merger and defended his actions by stating, "The proposed merger is likely to cause the type of industry concentration that Congress sought to curb at the outset."

2016

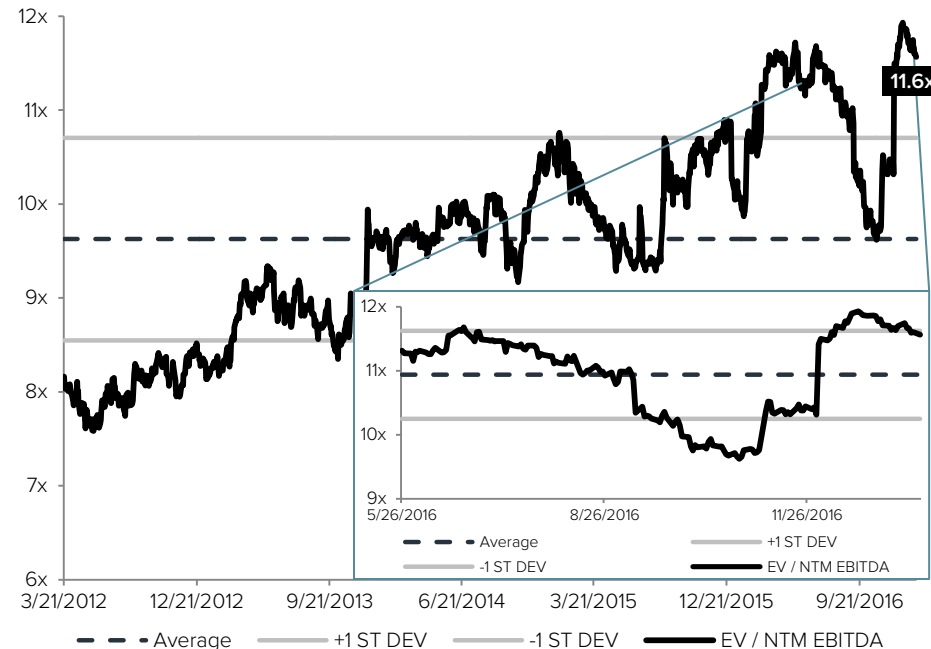
- On May 25, 2016, USFD went public, raising \$1.1B in its IPO.
- US Foods priced 44.4M shares at \$23, within its stated range of \$21 to \$24
- The stock finished its initial month at \$24.99.

# USFD VALUATION TREND VERSUS SY Y

## USFD Valuation Trend – Since IPO



## SY Y Valuation Trend – 5 year

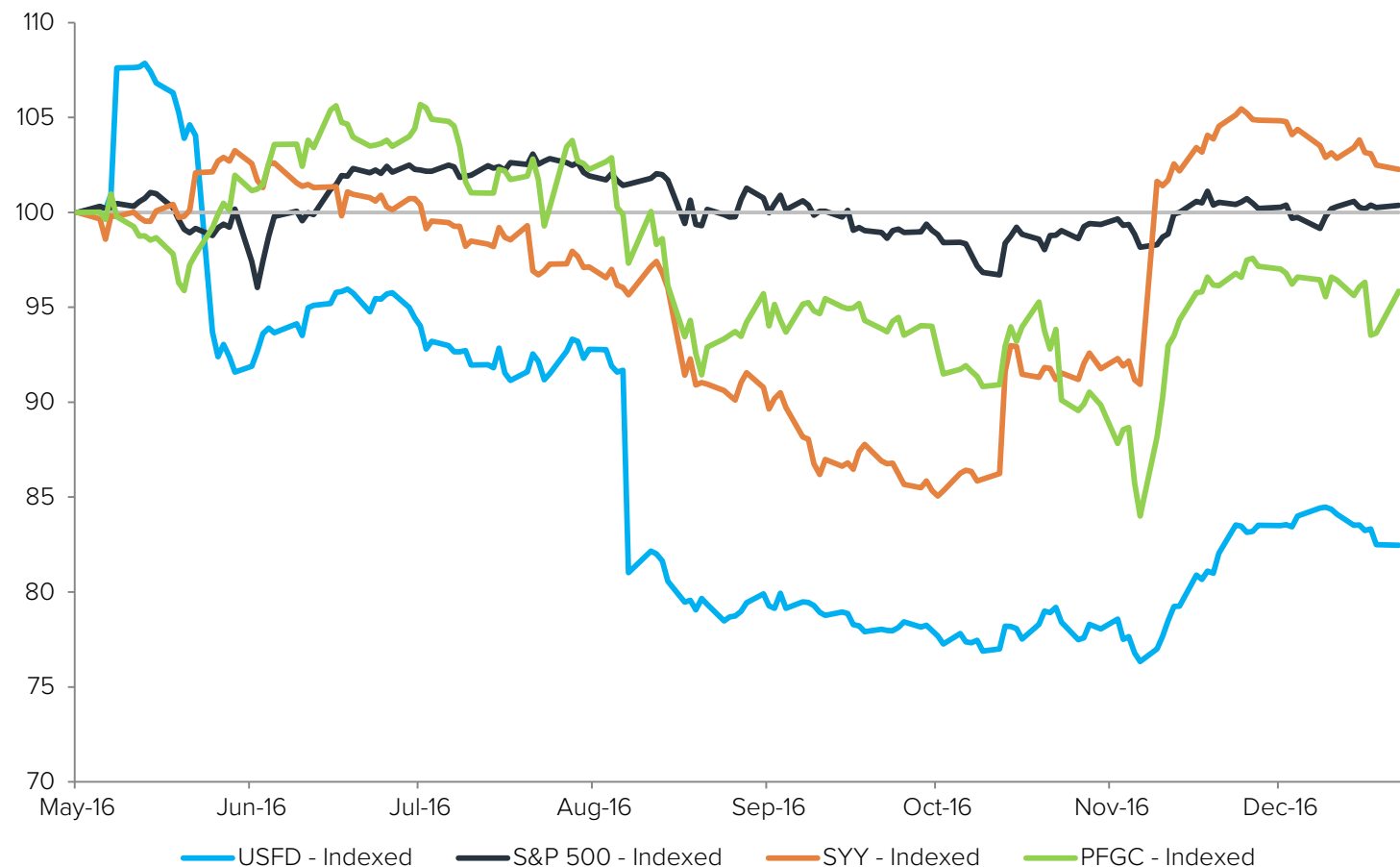


## USFD VALUATION HAS TRAILED OFF SINCE POST-IPO HIGHS

USFD is trading greater than two turns below SY Y (its most formidable competitor), and interestingly they both traded down in a similar fashion since USFD's IPO until SY Y's recent spike, as deflation ran rampant across the industry. We believe the discounted trading level is justified to some extent for the time being given the large insider ownership that will likely lead to selling over time, SY Y's better balance sheet and SY Y's sheer size, standing out among other reasons. But looking past that, USFD boasts far better growth prospects given their focus on independent restaurants. With those factors in mind we expect the valuation gap to close over time.

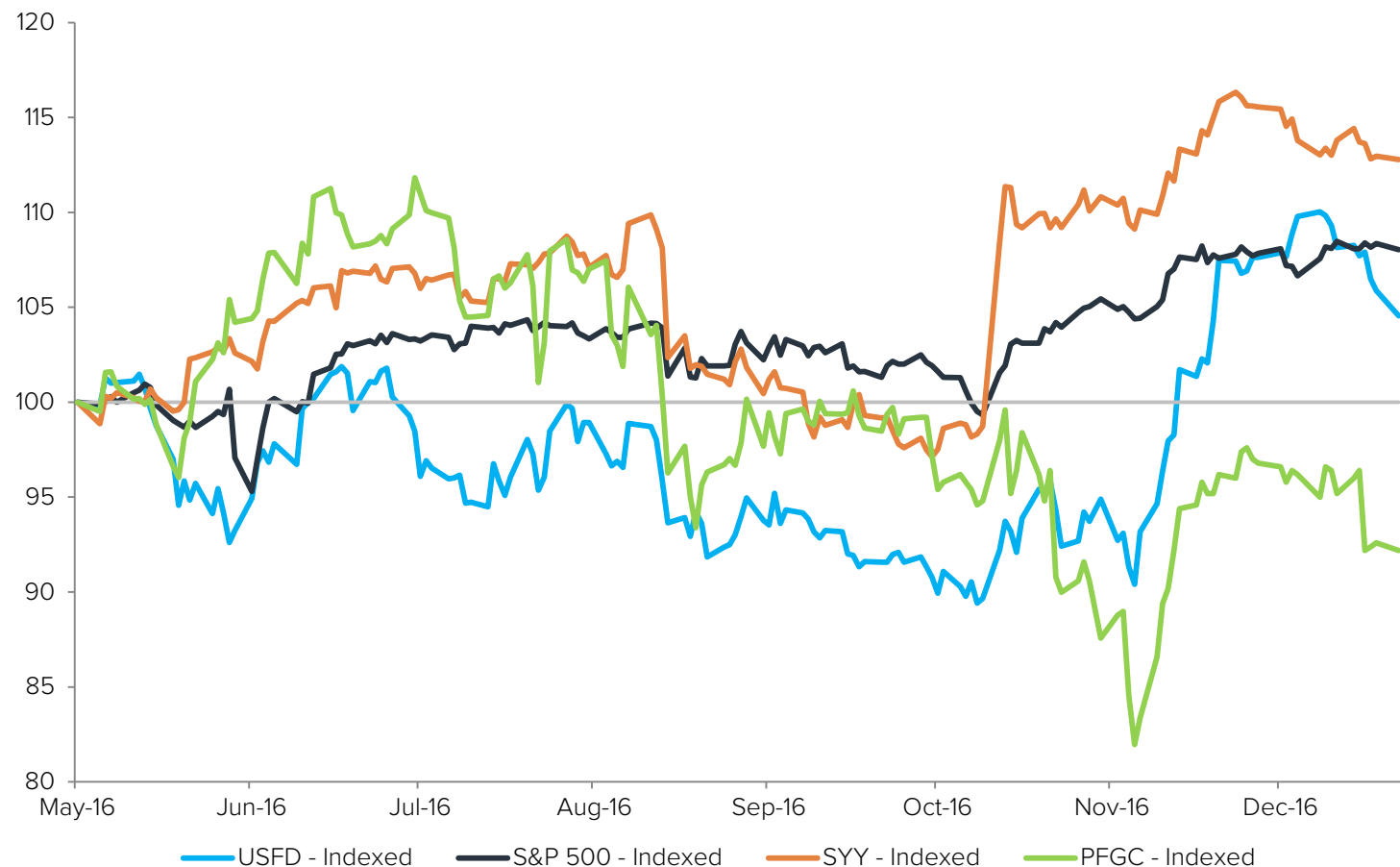


# USFD INDEXED EV/ NTM EBITDA VALUATION VS. PEERS



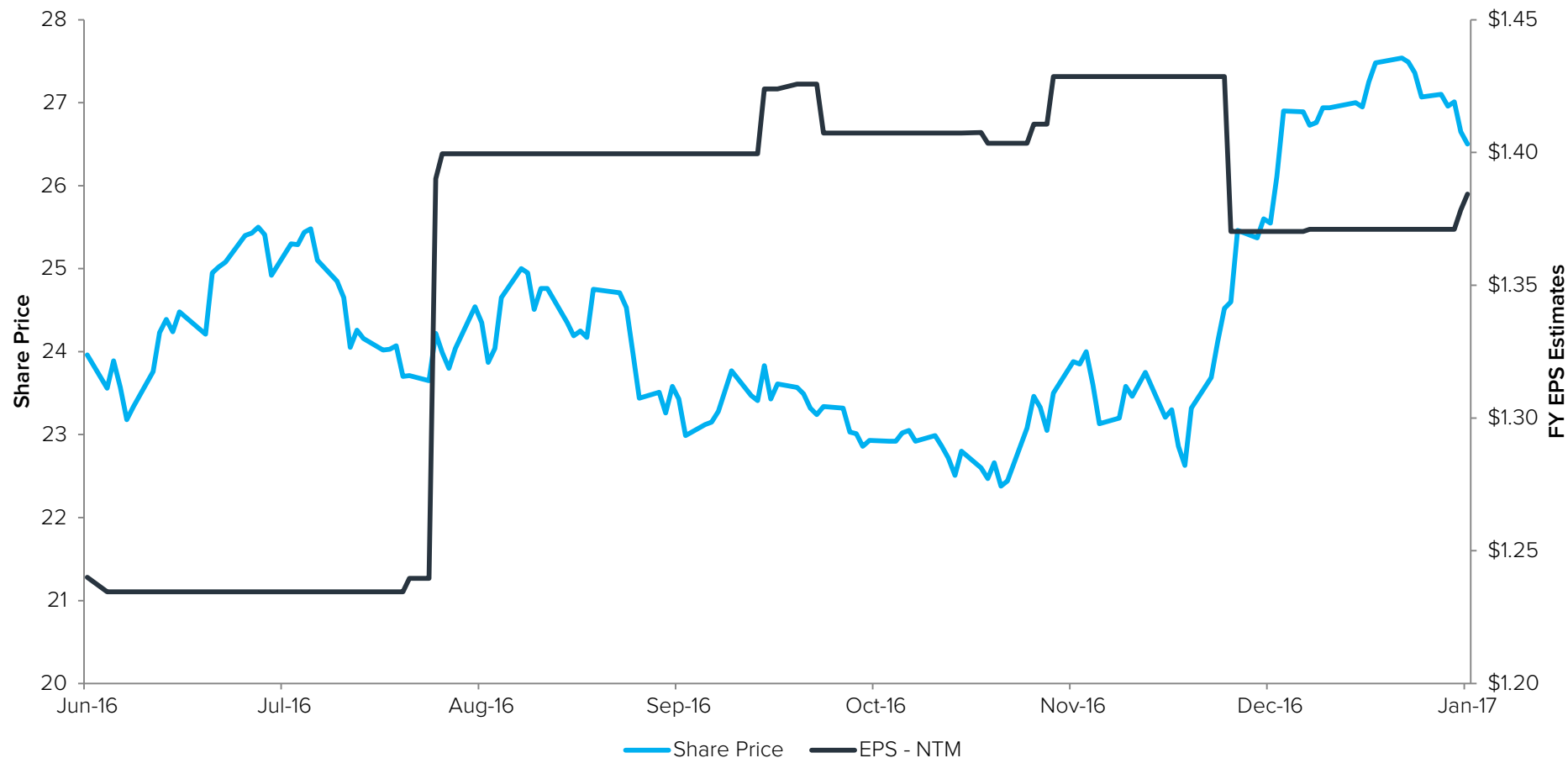
- Looking at USFD's valuation trend relative to close peers and the broader market, they are underperforming considerably given the high valuation they came out of the gate with.
- As we will explain throughout the deck, SYR has some differentiated aspects versus its peers that prevent it from going down too much.
- PFGC is the #3 in the Broadline landscape and is currently projected to grow top line in excess of USFD's with organic independent case growth of 8% in 1Q17.

# USFD INDEXED PRICE PERFORMANCE TREND VERSUS PEERS



- USFD has underperformed both SYY and the S&P 500, while outperforming PFGC since its IPO.
- Looking at more recent trends USFD has been a clear winner, up 15.6% in the last three months. Outperforming SYY and PFGC which were up 13.9% and down -6.0%, respectively.
- Notably, the food distribution stocks that we follow collectively have a median performance of 13.9% over the last three months, making them the best performing sub-sector in our consumer staples tracker.
- For reference the S&P 500 is up 6.97% in the last three months.

# NTM EPS REVISION TREND VS. STOCK PRICE

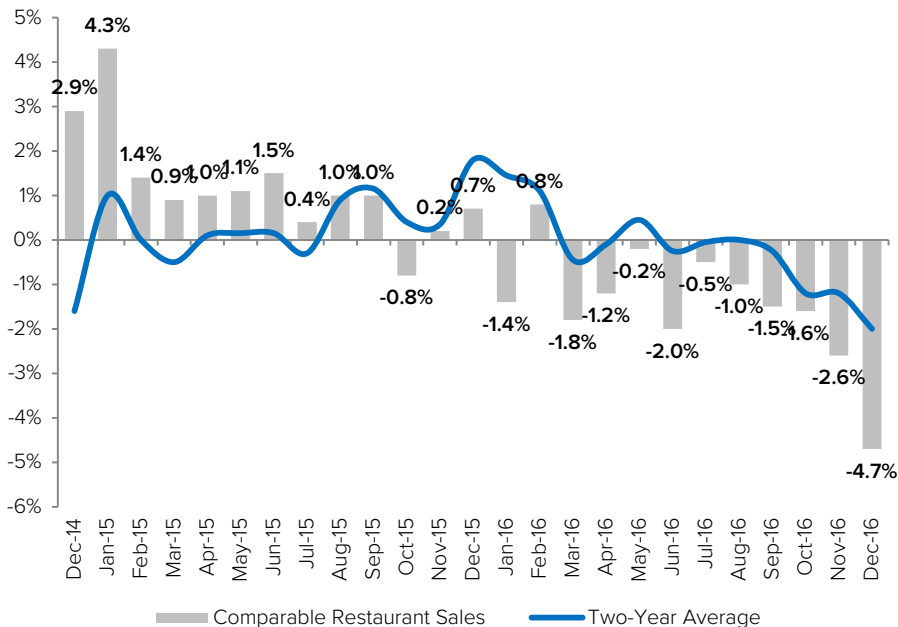




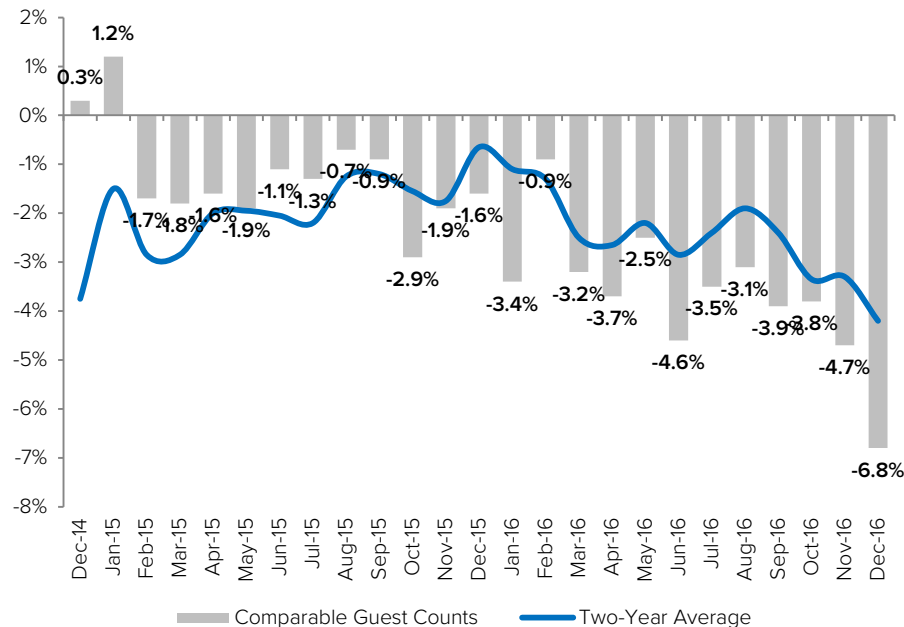
## RESTAURANT INDUSTRY EXPOSURE

# KNAPP-TRACK SALES AND TRAFFIC TRENDS

## KNAPP-TRACK COMPARABLE SALES



## KNAPP-TRACK COMPARABLE GUEST COUNTS

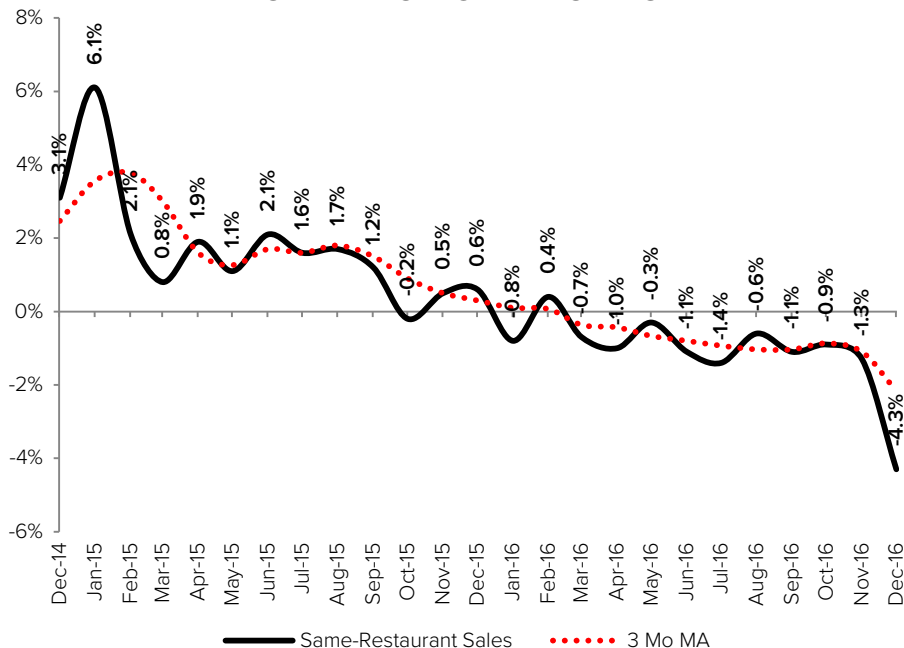


## RESTAURANT SALES ARE IN A SECULAR DECLINE...

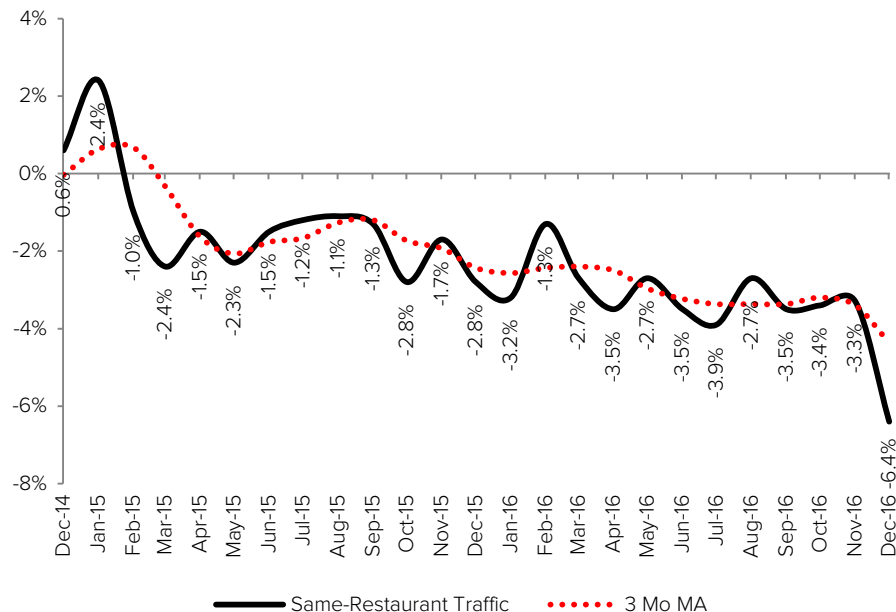
Casual dining sales trends as tracked by Knapp-Track continues to decline, but independents are fairing better and are in fact stealing share from old line chains. USFD's focus on these independents and their offerings that assist owners in operating more efficiently is feeding this dynamic in the restaurant industry.

# BLACK BOX SALES AND TRAFFIC TRENDS

## SAME RESTAURANT SALES



## SAME RESTAURANT TRAFFIC



## ...AND THERE IS NO END IN SIGHT

A broader look at the industry through Black Box points to the same bleak picture.

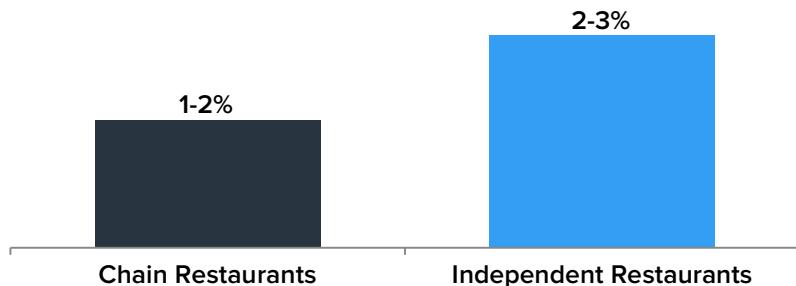
# GROWTH SKEWS TOWARDS INDEPENDENT OPERATORS

## INDEPENDENTS APPEAR TO BE TAKING SHARE

*“There is more growth in the total restaurant sector than in the chain restaurant numbers tracked by Black Box Intelligence, suggesting other players such as independent operators and smaller regional chains may be growing faster and taking away share from the chains.”*

- Sarah Atkinson Higgins  
Senior Director, Marketing & Communications  
TDn2K

### Projected Real Sales Growth

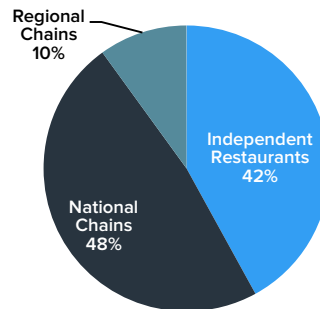


### Restaurant Performance Index



Source: NRA; Values Greater than 100 = Expansion; Values Less than 100 = Contraction

### 2015 Industry Sales of \$162 Billion



- In Technomic's latest update regarding their outlook of the restaurant industry released on 11/29/16, Joe Pawlak, Technomic Managing Principal stated, *“Consumer economic uncertainty, value issues, and undifferentiated positions are putting strains on many full service chains. However, independents seem to be holding their own as consumers are gravitating to these establishments due to their unique offerings, local orientation and strong value propositions.”*
- “The best friends of distributors are the independents because they are a much more profitable business for the distributors,” says Technomic's Goldin.
- “Selling to a chain, distributors are lucky to get 10 percent margins. Selling to an independent, they are more likely to get 20 percent margins.”

# LIFE, LIBERTY...AND INDEPENDENTS!

## Independent Restaurants & Small/Regional Chains

- Foodservice distribution sales to independent restaurants and small chains were estimated at \$64B in 2015, with a projected CAGR of 3.2% over the next five years.
  - Regional chains were estimated at \$15 billion in 2015 and projected to grow at a 1.2% CAGR over the next 5 years.
- Independent restaurant owners are usually more involved in the end-to-end processes of the business, which often leads to a more passionately run restaurant.
- A lean independent-management structure leads to faster decision making and allows for seamless pivots towards new recipes and ideas.
  - No board of directors or investors to worry about when making a change.
- Changes to the menu are done for the betterment of the customer experience or to offer customers a varied menu offering, not necessarily in order to improve margins.

*“These restaurants typically differentiate themselves on their overall dining experience and a quality, diverse menu.”*







## **KEY DIFFERENTIATORS**

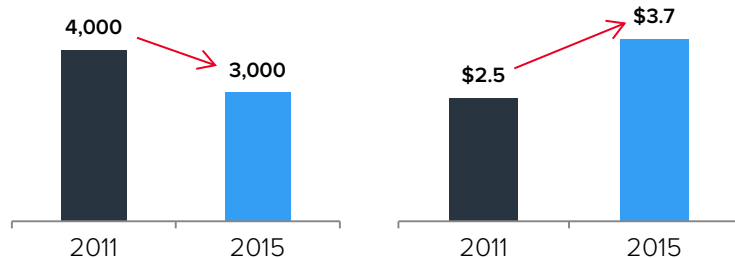
# E-COMMERCE & SUPPORT SERVICES

## “MADE EASY”...TO IMPROVE THE CUSTOMER EXPERIENCE

- The Company sees significant growth in e-commerce and the adoption of mobile technology by foodservice operators, and believes that investing in these capabilities will give them a competitive advantage.
  - Their e-commerce tools and mobile solutions make it easier for customers to conduct transactions with USFD, subsequently increasing customer adoption and loyalty.
  - USFD’s mobile and e-commerce platforms allow customers to easily place orders, track shipments, view product information, and verify orders once they are delivered.
- The Company is increasing sales force efficiency through e-commerce offerings.
  - Net sales dollars per sales associate increased by over 30% from 2012 to 2015 (\$4 million to \$5.4 million).
  - In fiscal 2015, \$15B in net sales were generated through USFD’s e-commerce platforms, representing 67% of total sales compared to 52% in fiscal 2011. Comparatively, e-commerce accounts for only 8% (2Q16) of Sysco’s sales.
  - Percent of sales from e-commerce to independent restaurants has risen from ~8% in 2011 to ~51% in 2016.
- Product Innovation: USFD supports their industry-leading product innovation with high-impact nationwide launches via Scoop.
  - Over 400 product launches
  - Majority of products featured are private label brands
  - \$1.2 billion in cumulative new sales
  - 3 Scoop launches per year (20-25 items per launch)
  - Over 50% customer trial, with a 7% prior customer retention rate

Number of Local Sellers

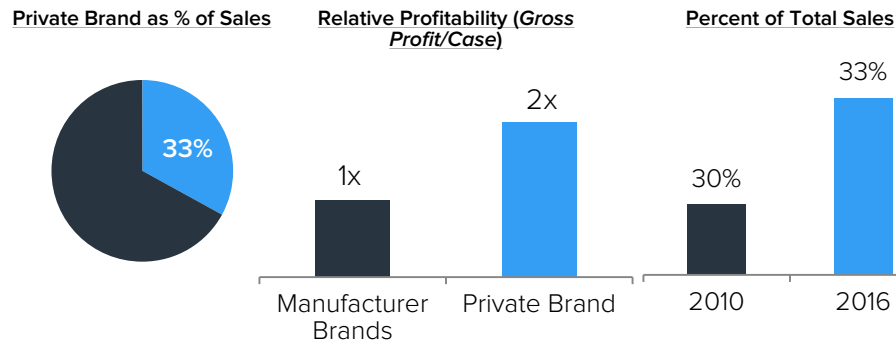
Average Route Size (\$M)



# PRIVATE LABEL ADVANTAGE

## Private Brand Penetration

- USFD's private brand program includes an extensive and growing assortment of over 14,000 products across more than 20 brands, contributing \$7.3B (32%) in net sales in fiscal 2015 (private brands products had represented ~30% of total sales in both 2015 and 2014).
- The Company's private label lineup has grown by approximately 1,200 products since 2013.
- Despite already having an extensive private brand lineup, the Company still sees this as a significant growth opportunity.
  - Their private brand products typically have higher gross margins compared to similar brand-name offerings.
  - USFD's private brand products are generally priced below comparable manufacturer brands.
- The Company plans to drive private brand growth through center-of-plate and produce penetration, seller penetration, specialists deployed in field, stock-yards expansion, produce logistics, and acquisitions.



## Key Product Differentiators

- USFD's "Serve Good" initiative includes products that are responsibly sourced or contribute to waste reduction.
- These products are developed with suppliers that are verified by third-party certifiers, including:
  - The American Humane Association
  - The Marine Stewardship Council
  - The Global Aquaculture Alliance
  - The Fishery Improvement Project
  - The U.S. Department of Agriculture
  - The Non-GMO Project
  - The Biodegradable Products Institute
- Fun Fact:** US Foods was the first foodservice distributor to nationally launch a grass fed, all-natural, hormone free, minimally processed beef burger, further differentiating itself from competitors.



# VALUE-ADDED OFFERINGS

## Team Based Selling

Territory Sales Manager

Sales Rep

Product specialist

Restaurant Operations  
Consultant (ROC)

Chefs

- A key differentiator is USFD's ability to offer customers valuable tools and services that assist in increasing sales, and improve operations while minimizing waste and costs.
- Available to USFD customers is an array of tools, including business experts to assist with the follow:
  - **Marketing**
  - **Operations and Startup**
  - **Financial and Food Cost**
  - **Point of Sale**
  - **Staffing and Scheduling partners**
- **Blueprint Menu Management System:** Assists healthcare foodservice operators with cycle menu planning and execution.
  - In addition to building menus, therapeutic diets and corresponding reports, this web-based tool also provides Price Per Patient Day costing and product-specific reporting.
- **Recipes On-Demand:** Additional value-add comes in the form of recipes, developed by USFD chefs and available to customers, via their Blueprint Menu Management System.
- **CookBook analytics:** drives consumer insights and case growth through targeted offers and promotions.

# OUR FIRST HAND EXPERIENCE WITH USFD

I (Howard Penney) sit on the Board of Directors of a local independent Club/Restaurant on the South Coast of Massachusetts.

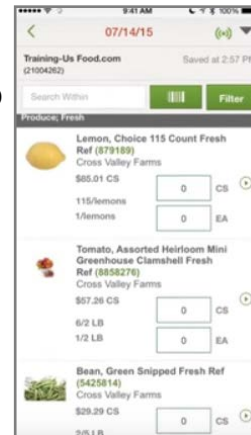
In an effort to lower food cost, the Board went through the process of comparing our current distributor, Sysco, with that of what US Foods has to offer.

The process is ongoing, but it's clear that the US Foods suite of products are much more aligned to the independent restaurant operator.

In addition to my first hand experience, we have talked to a number of independent restaurant operators that have had a similar experience and rave about the efficiencies/capabilities and the technological offering that USFD enables in their restaurants.

## Key Takeaways

- 1 Robust tools to enable independent restaurant success
- 2 Food Cost Initiatives - actual vs theoretical food costs
- 3 Food Fanatics - Chef can attend the chefs and restaurateurs at their Food Fanatics Live™ Culinary Expo
- 4 Technology – Mobil ordering app
- 5 Menu Profit Builder Pro
- 6 ChowNow (Take-out app)



# REINFORCING DEFENSES

- US Foods' ChefStore is their wholesale concept, aimed at attracting customers through hundreds of unique products (national and private brands) and monthly specials.
  - Approximately 49% of sales at ChefStore locations are to existing USFD customers.
- ChefStore is USFD's attempt to fend off competitive intrusion, especially in the small, independent operator space, where cash and carry warehouse stores such as Restaurant Depot, and to a lesser extent, Jetro, service much of the country.
- ChefStore is still in the pilot phase, and USFD is at a disadvantage, given Restaurant Depot's significant unit advantage:
  - Restaurant Depot: **109** locations
  - Jetro: **12** locations
  - ChefStore: **4** locations
- However, the ChefStore concept is meant to pick up incremental dollars...essentially, USFD is fighting for those customers who are floating at the margins and hoping that their ChefStore concept resonates well with them.
- USFD currently does not have plans for international expansion, as they still see plenty of growth opportunities within the U.S.

## Restaurant Depot, Jetro, and ChefStore Locations



**CHEF'STORE**  
GREAT FOOD. WHOLESALE PRICES.



**HOSPITALITY AND OTHER**

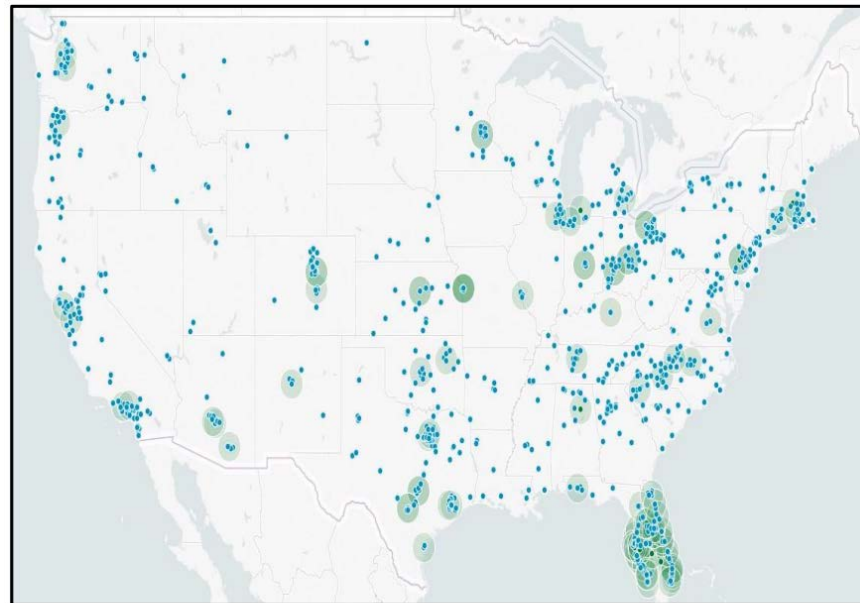




# HOSPITALS & NURSING HOME GROWTH

- USFD supplies approximately 250,000 customer locations nationwide consisting of independently owned single and multi-unit restaurants, regional concepts, national restaurant chains, **hospitals, nursing homes, hotels and motels...**
- *“The second contributor was growth with other customer types we are targeting, **mainly healthcare and hospitality**. Last call, I discussed our win with Brookdale Senior Living, **the largest senior living operator in the country, with over 1,000 communities...** Brookdale is a good example of the momentum we are beginning to see with prospective customers in **the healthcare and hospitality space where we want to grow at a rate above the market**” (Pietro Satriano, 3Q16 Earnings Call)*
- Healthcare customers were estimated to comprise \$13B in foodservice distribution sales in 2015, and is projected to grow at a 3.5% real CAGR over the next 5 years.
- Healthcare customers have complex food service needs given their scale, need for menu diversity and logistics considerations, all characteristics that play into USFD’s hands as their Blueprint Menu Management System is built to fill such needs.
  - Offers a cycle menu planning program that is seamlessly integrated with existing US Foods applications
  - Builds menus, therapeutic diets and corresponding reports

## Brookdale Senior Living Facilities



● Brookdale communities

● Ancillary services network





# HOTEL GROWTH



## GROWING ADDRESSABLE MARKET

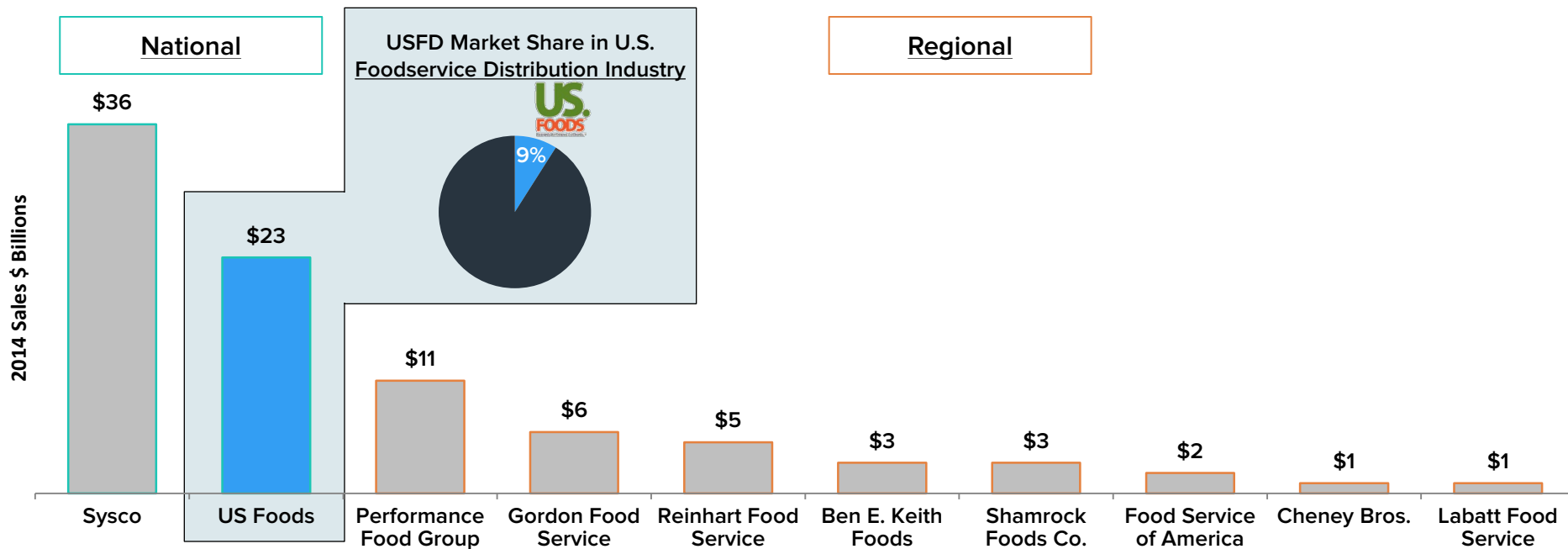
- The hospitality segment accounted for an estimated \$18B in foodservice distribution sales in 2015, and is projected to grow at a 3.5% real CAGR over the next five years.
- With food playing a key role in guest satisfaction, hospitality customers undoubtedly appreciate the menu planning and operational assistance offered by USFD.
- USFD hopes to grow at a rate above the market in the hospitality space.



**M&A OPPORTUNITIES ABOUND**

# FRAGMENTED INDUSTRY RIPE FOR CONSOLIDATION

## U.S. Broadline Sales of Top 10 Foodservice Distributors



## ROOM FOR CONSOLIDATION











The foodservice distributor industry is a very fragmented one, with over 15,000 local and regional distributors, cash & carry and club store competitors. There is ample room for consolidation, which USFD has already contributed to on a smaller scale with 5 deals in roughly the last year, with an estimated net sales run-rate of \$450 million to \$500 million.

# PRECEDENT TRANSACTIONS / POSSIBLE TARGETS

## Recent USFD Deals

<u>Company</u>	<u>Location / Date</u>	<u>Annual Sales (\$mm)</u>	<u>Strategic Rationale</u>
 <b>DIERKS WAUKESHA</b> The Food Service Source®	Wisconsin / Dec. 2015	\$120	Share growth with independents
 <b>CARA DONNA</b> All The Ingredients For Your Success	Massachusetts / March 2016	\$107	Share growth with independents
 <b>Freshway FOODS</b>	Ohio / May 2016	\$130	Produce processing
 <b>JERACI FOODS</b> QUALITY FOODS FROM AROUND THE WORLD	New York / Sept. 2016	\$26	Share growth with independents
 <b>SAVE ON SEAFOOD</b>	Florida / Oct. 2016	\$80	Strengthen seafood sourcing

## Select Deals in the Space

<u>Date</u>	<u>Target</u>	<u>Acquirer</u>	<u>Annual Sales (\$mm)</u>
Feb. 2016	 <b>NORTH STAR SEAFOOD, LLC</b> FLORIDA'S FRESHEST SEAFOOD	 <b>Sysco</b>	\$128
June 2016	 <b>I Love MT FOOD SERVICE</b>	 <b>thechef'sWAREHOUSE</b>	\$55
Sept. 2016	 <b>Kelley's</b> "A Great Taste In Generation"	 <b>KEITH CO.</b>	NA
Oct. 2016	 <b>Kinnealey</b> QUALITY MEATS	 <b>PFG</b> Performance Food Group	\$70
Oct. 2016	 <b>Black River PRODUCE</b>	 <b>Reinhart FoodService</b>	\$75

## Possible Targets

 **BIRITE** FOODSERVICE DISTRIBUTORS  
California  
Est. Sales: \$310mm

 **MERCHANTS FOODSERVICE**  
Mississippi  
Est. Sales: \$650mm

 **PFG** Performance Food Group  
Virginia  
Est. Sales: \$16.7bn

 **Cheney Brothers** C-B-I  
Florida  
Est. Sales: \$1.6bn

 **Shamrock Foods**  
ARIZONA  
Est. Sales: \$3bn

 **SAVAL** FOODSERVICE  
Maryland  
Est. Sales: \$125mm

 **Labatt** FOOD SERVICE  
Texas  
Est. Sales: \$1bn

 **FOOD SERVICES OF AMERICA**  
Arizona  
Est. Sales: \$2bn

 **KEITH CO.**  
Texas  
Est. Sales: \$3bn

## M&A is Critical to the Space

- With over 15,000 local and regional competitors in the food distribution space, consolidation will play a critical role for the foreseeable future.
- Given the FTC's decision in the SY/USFD deal it is less likely that USFD would acquire a top five competitor, thus making it more likely that they will continue to make tuck in acquisitions.
  - USFD has a dedicated team at HQ to seamlessly integrate tuck in acquisitions and capture synergies.
- This doesn't mean that PFGC can't do something with someone that is smaller than them in order to be a stronger #3.

## Lessons Learned From SY

- The FTC challenged the proposed merger between SY and USFD saying it "would create a national Broadline foodservice distributor with 75% market share, and harm customers in numerous local markets."
- The two parties came away from the negotiating table thinking that going forward there would be no combination of the #1, #2 or #3 players that would pass the regulators' smell test.
- With Trump speaking out against the proposed AT&T / Time Warner deal it appears that conditions will not get more favorable during his presidency.

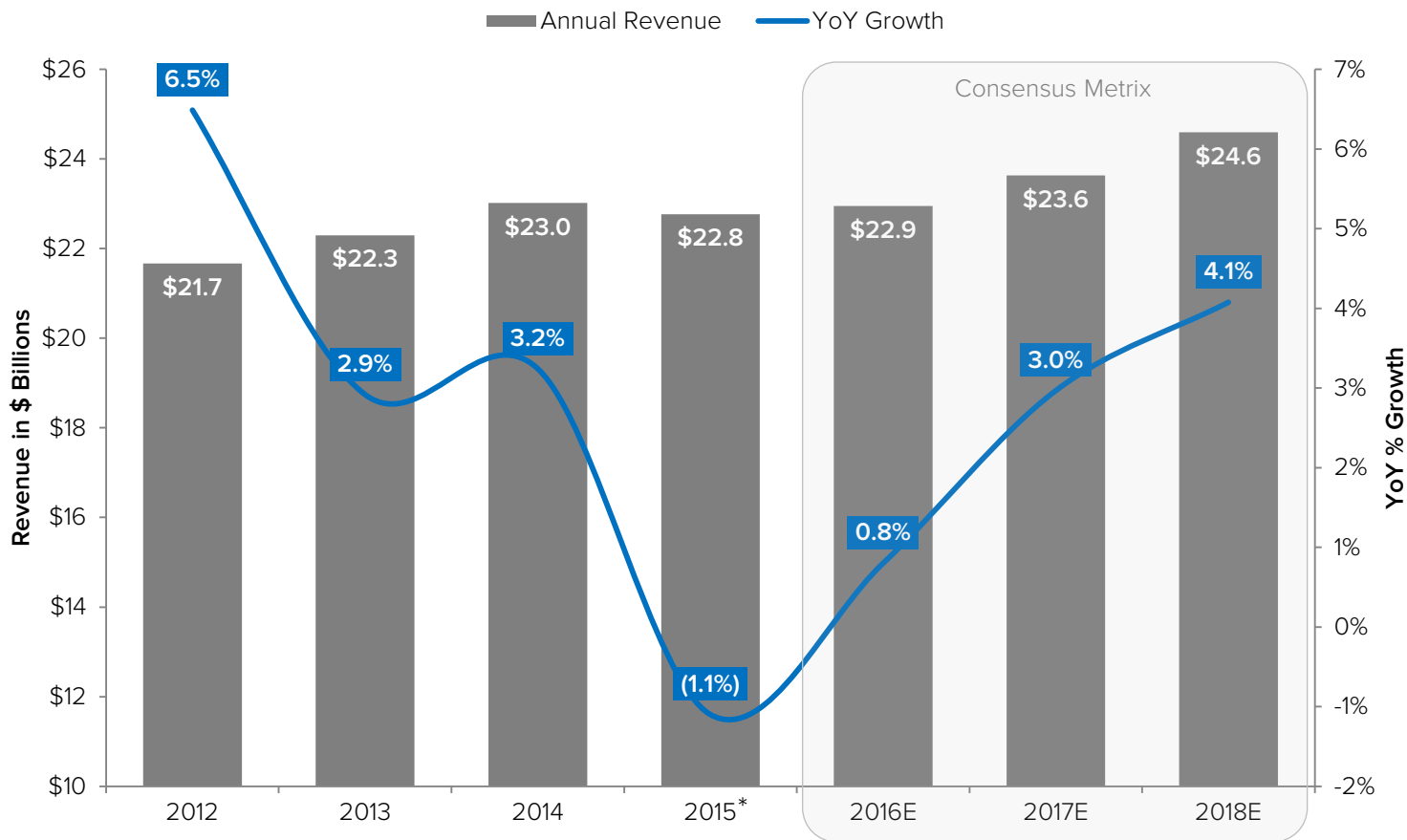
## PFGC is a Distant Target

- The teams already know each other very well, as PFGC was set to acquire certain DC's if the proposed merger between USFD and SY went through.
  - As part of the deal PFG was set to buy 11 US Foods distribution centers, and the FTC determined that was not enough for PFG to effectively compete against the combined entity, these management companies know each other well.
- Notably, George Holm PFGC CEO is a former employee of both USFD and SY, among other notable distributors.
- A lot of synergies if the two were able to get a deal done.
- Although we think it would go through regulatory approvals, management has been adamant they are focused on smaller deals for now.



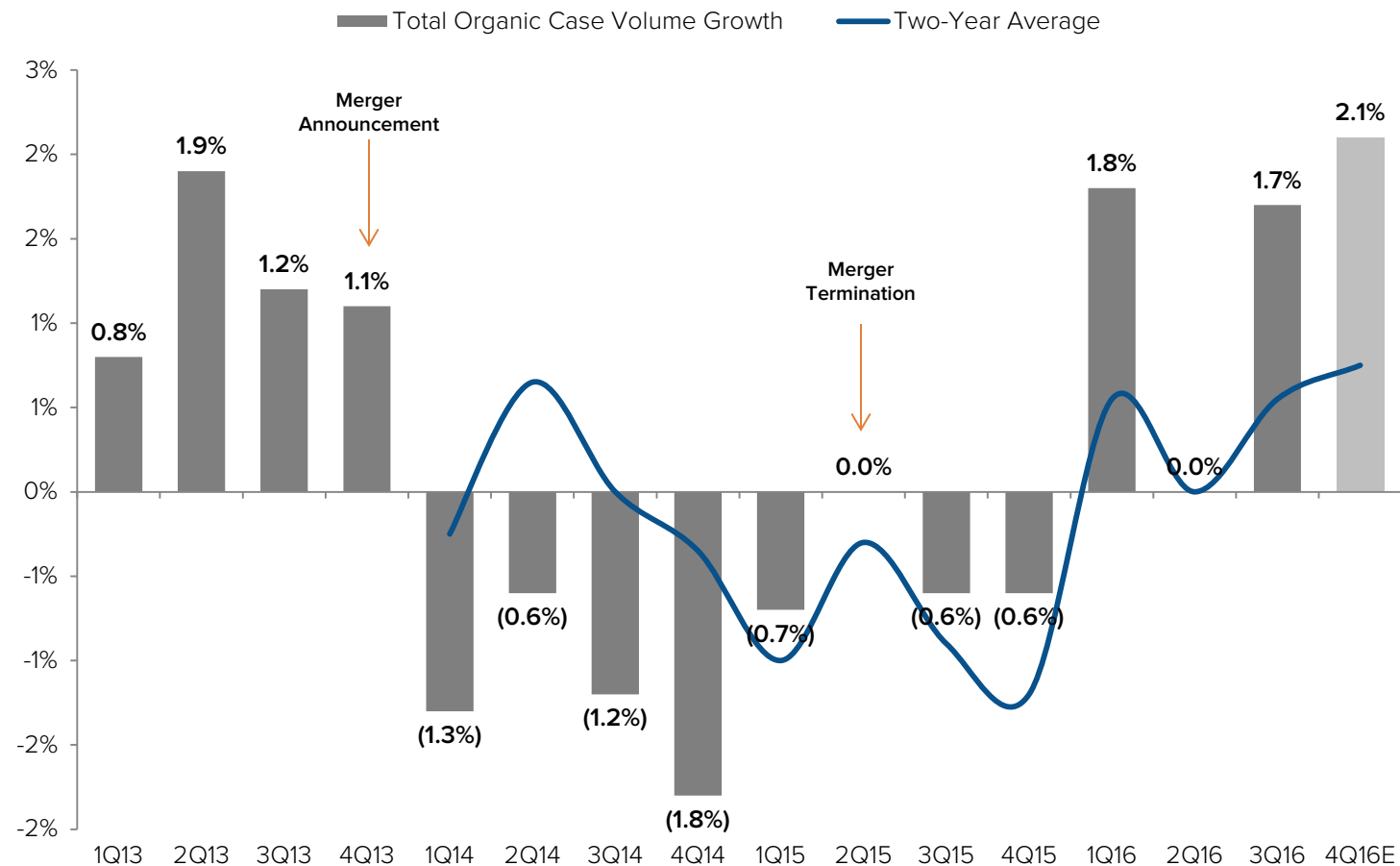
**USFD TOP LINE GROWTH**

# US FOODS ANNUAL REVENUE



- USFD's revenues have seen varying growth over the years as they have refocused their business on higher margin opportunities such as independent restaurants.
- Additionally, they went through a lull when they were contemplating the merger with SYY, restaurants wanted to see where that landed before they signed on.
- Net sales have also been hampered by persistent deflation given a meaningful portion of their sales are cost-plus.
- Internal mid-term targets are for net sales growth of 4 – 6%.

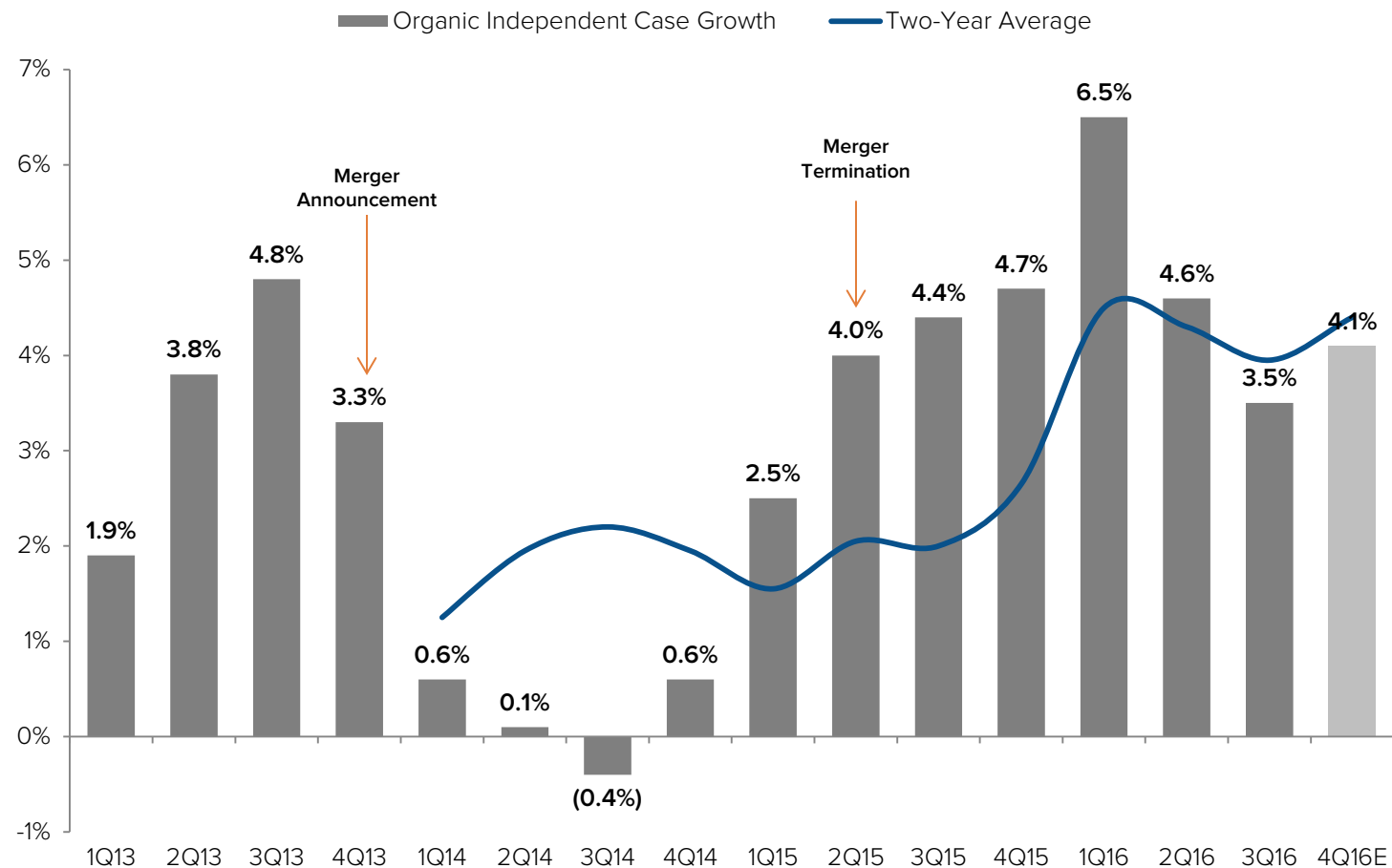
# TOTAL ORGANIC CASE GROWTH



- The Company is working hard to grow relationships with existing customers, while also attracting new customers.
- In 3Q16, total case growth was 4%, while organic case growth was 1.7%.
- Total organic case growth is estimate to be 2.1% in 4Q16, which is 0.8% on a two-year basis, representing a 20bps sequential acceleration.
- Mid-term targets stated by the company project unit growth of 2 – 4%, the higher end reflects the impact of acquisitions.



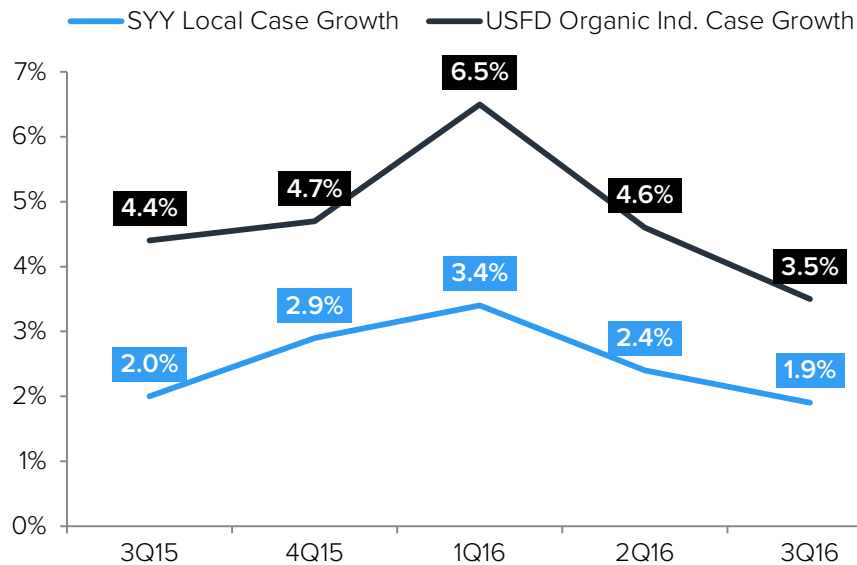
# ORGANIC INDEPENDENT CASE GROWTH



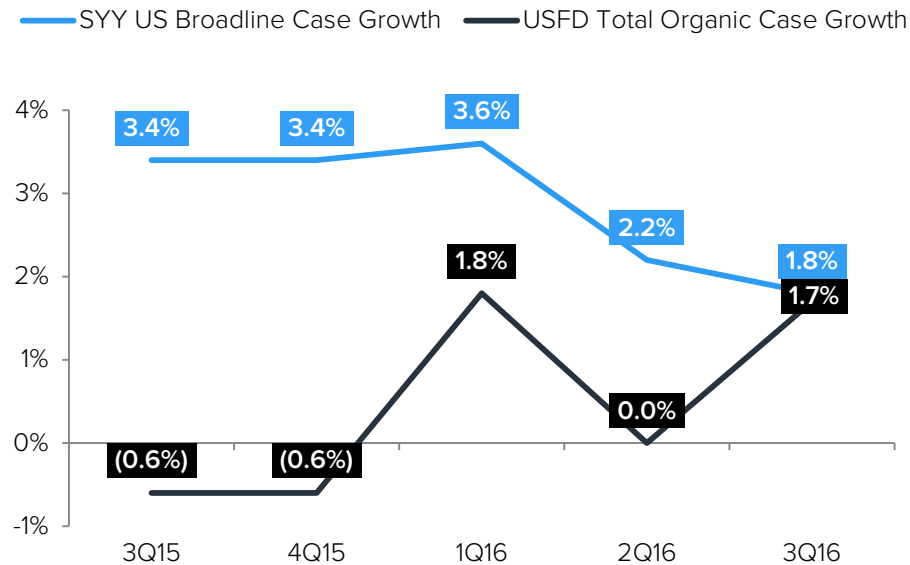
- USFD's growth with independents is outpacing their overall case growth as they put greater focus on this customer base.
- The pre-released 4Q16 results estimate that USFD will see 4.1% organic independent case growth, or 4.4% growth on a two-year basis, which represents a 40bps increase sequentially.
- Case growth in independents is increasingly impacted by acquisitions as USFD acquires top notch distributors with a deep customer list of independent restaurants.

# USFD CASE GROWTH VS. SY Y

## Independent Case Growth



## Total Case Growth



*\*Please note that dates provided are calendar year to match USFD's reporting, 3Q16 is 1Q17 for SY Y*

## THE RACE TO SUPPLY INDEPENDENTS

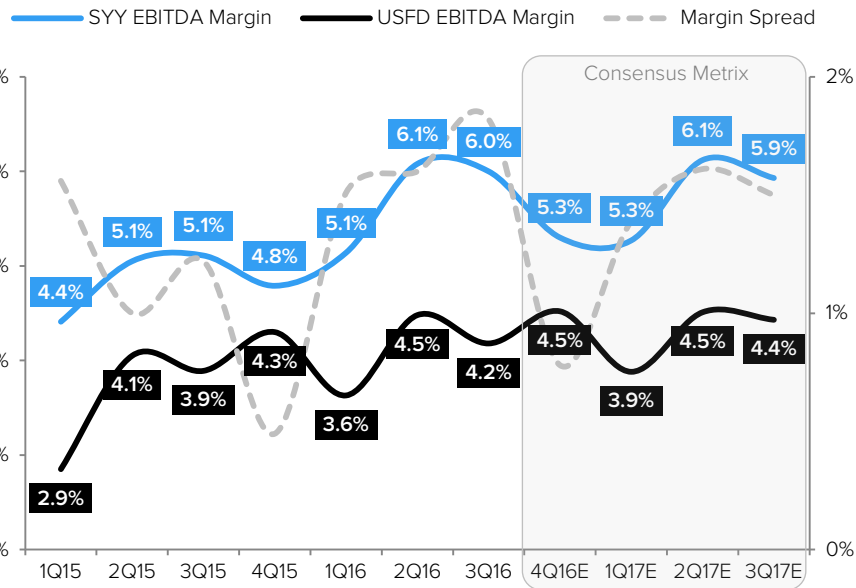
USFD is rapidly gaining market share with the independents as they shift the focus of their business to a higher profitability customer mix. Although SY Y remains a size and profit margin leader, USFD's continued growth above and beyond SY Y's with independents will help close the profitability gap over time.



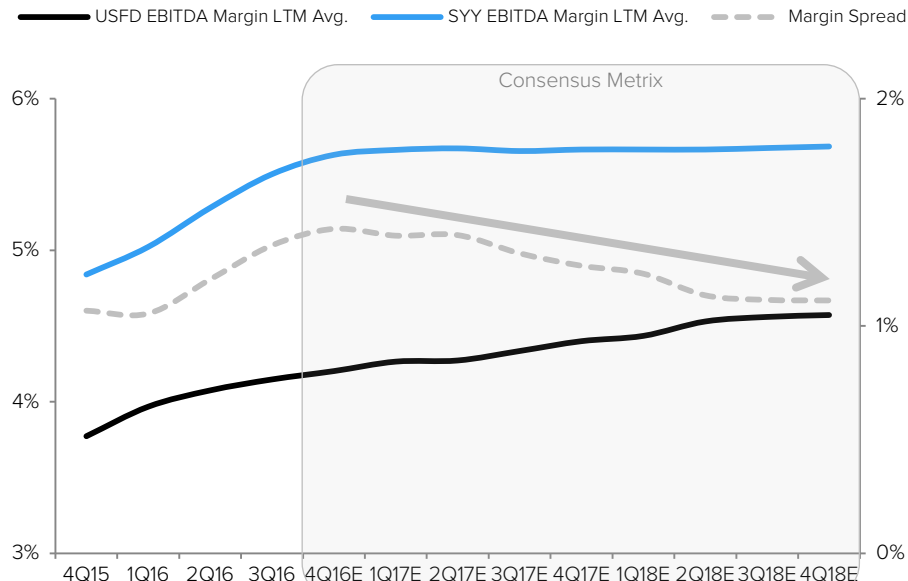
## MARGIN ANALYSIS

# USFD HAS ROOM FOR IMPROVEMENT

## EBITDA Margin Spread



## LTM Average Margin Spread



*\*Please note that dates provided are calendar year to match USFD's reporting, for example 3Q16 is 1Q17 for SY Y*

A critical aspect to USFD receiving a higher multiple closer to its top competitor SY Y, is closing the margin gap. Clearly, given these Consensus Metrix estimates above on the left, they do not see USFD gaining meaningful ground in the near term given SY Y's sheer size and best in class private label offering will give them separation. Looking towards the 2H of 2017 and into 2018 consensus is projecting USFD to close the gap as SY Y hits a plateau. We believe there is potential for the gap to close further.

# MARGIN IMPROVEMENT THROUGH MULTIPLE AVENUES

## Cost Cutting Initiatives

### **COST CUTTING**

- USFD is taking a 3G approach to cutting its indirect spend, targeting roughly \$1.2 billion in addressable spend.
- This includes every thing from tires to travel.

### **FIELD REDESIGN**

- USFD has reduced their salesforce from 4,000 in 2011 to 3,000 in 2015.
- Enhanced team based selling approach.
- Implementation of e-commerce enabling fewer sales reps to generate more revenue.
- Adopted the multi-site approach to managing the field, going from 62 leadership teams (one at each distro) to 26 and from 8 region teams to 5, bringing back office staff to a more centralized location.

### **STREAMLINE FOOTPRINT**

- Closed distribution center in Florida in 2015 and in April 2016 announced plans to close a distribution center in Baltimore which has the lowest profitability in its fleet.
- As they acquire new distributors USFD is always looking at the possibility of rationalizing facilities.

## More Strategic Opportunities

### **PRIVATE LABEL EXPANSION**

- 30% to 33% in 3 years, PL boasts a 2x margin profile to manufactured brands.
- Working on closing gap to SYG on PL.
- Scoop has been huge for the growth of this product portfolio.
- Continue to invest in expanding offerings that make life easier for independent operators.

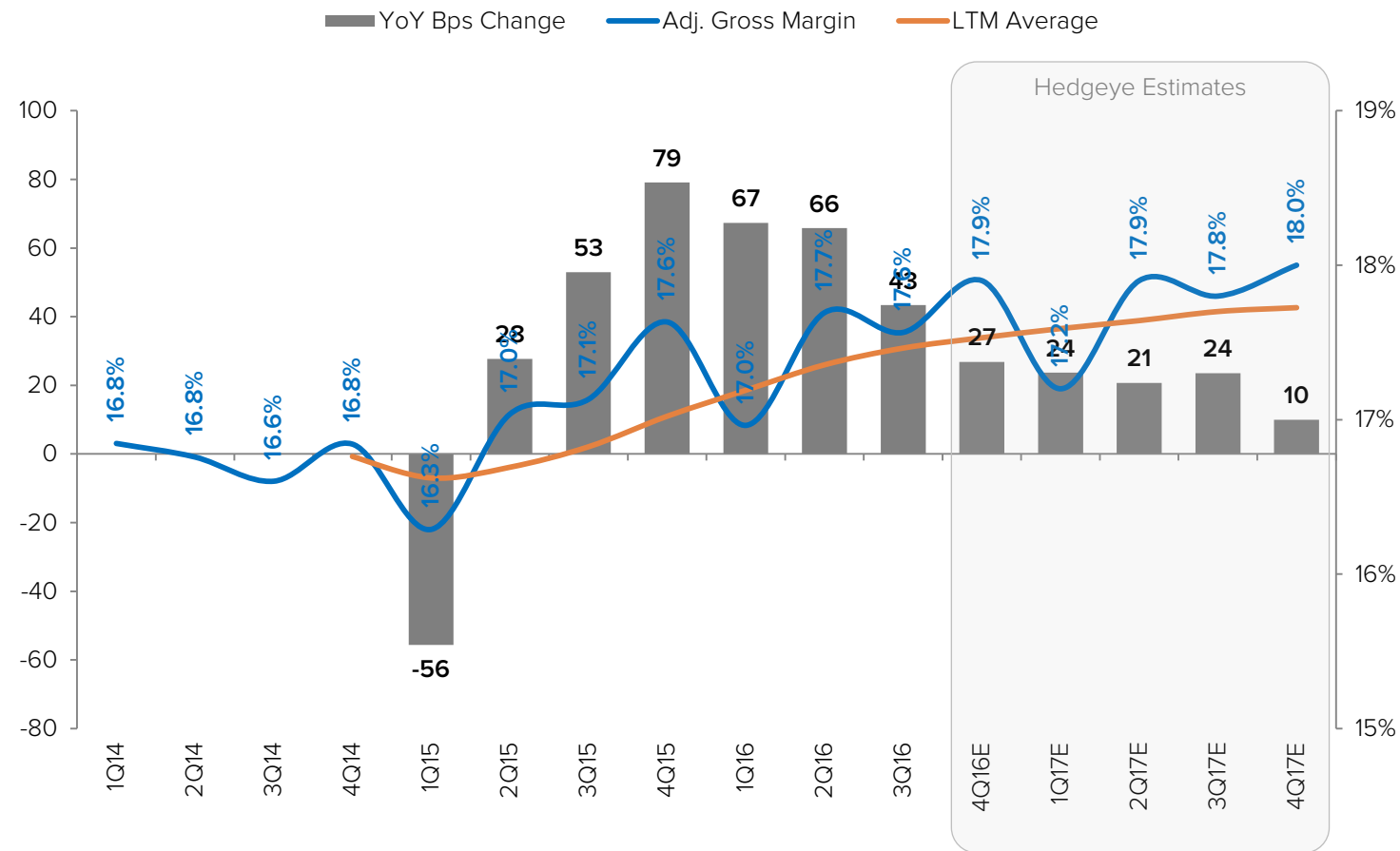
### **M&A**

- Tuck in acquisitions are a priority going forward.
- Expect run-rate similar to 2016 on a per year basis.
- Now have a dedicated team online at HQ ready to seamlessly integrate these businesses.

### **TECHNOLOGY IMPLEMENTATION**

- E-commerce penetration with independent restaurants has grown to 51% of sales which is a huge advantage and enforces customer stickiness.
- Sales growing due to industry leading technology platform and value added services, given so much of the distributor business is cost-plus, making sure your customers are getting perceived value is critical.

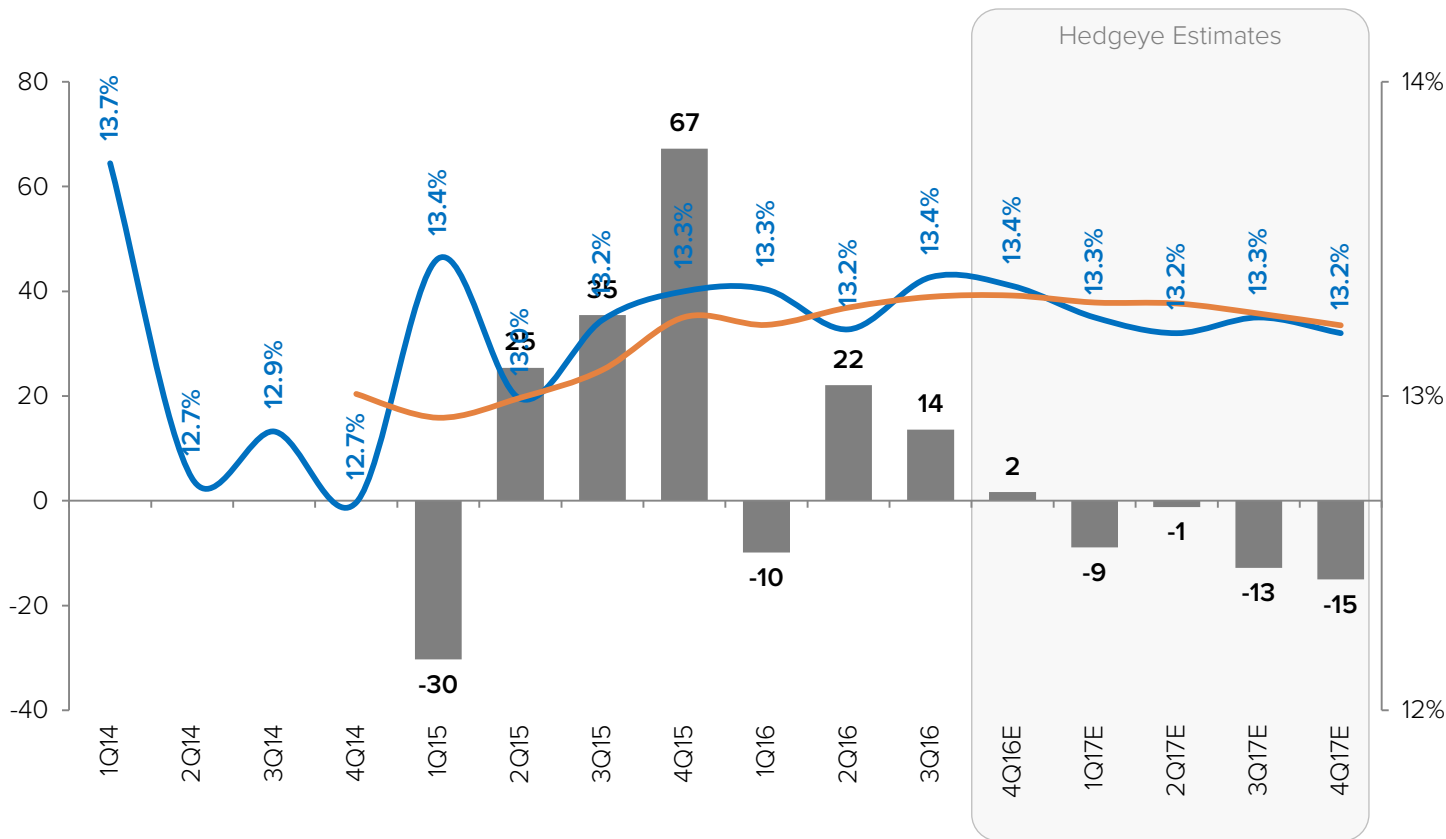
# ADJ. GROSS MARGIN



- Although deflation has been a headwind, USFD's initiatives such as shifting customer mix to more independents, increase PL brands as a % of sales and strengthen category mix by focusing on produce and center of plate has improved their gross margin.
- As a result of these initiatives USFD was still able to muster 43bps of gross margin expansion.

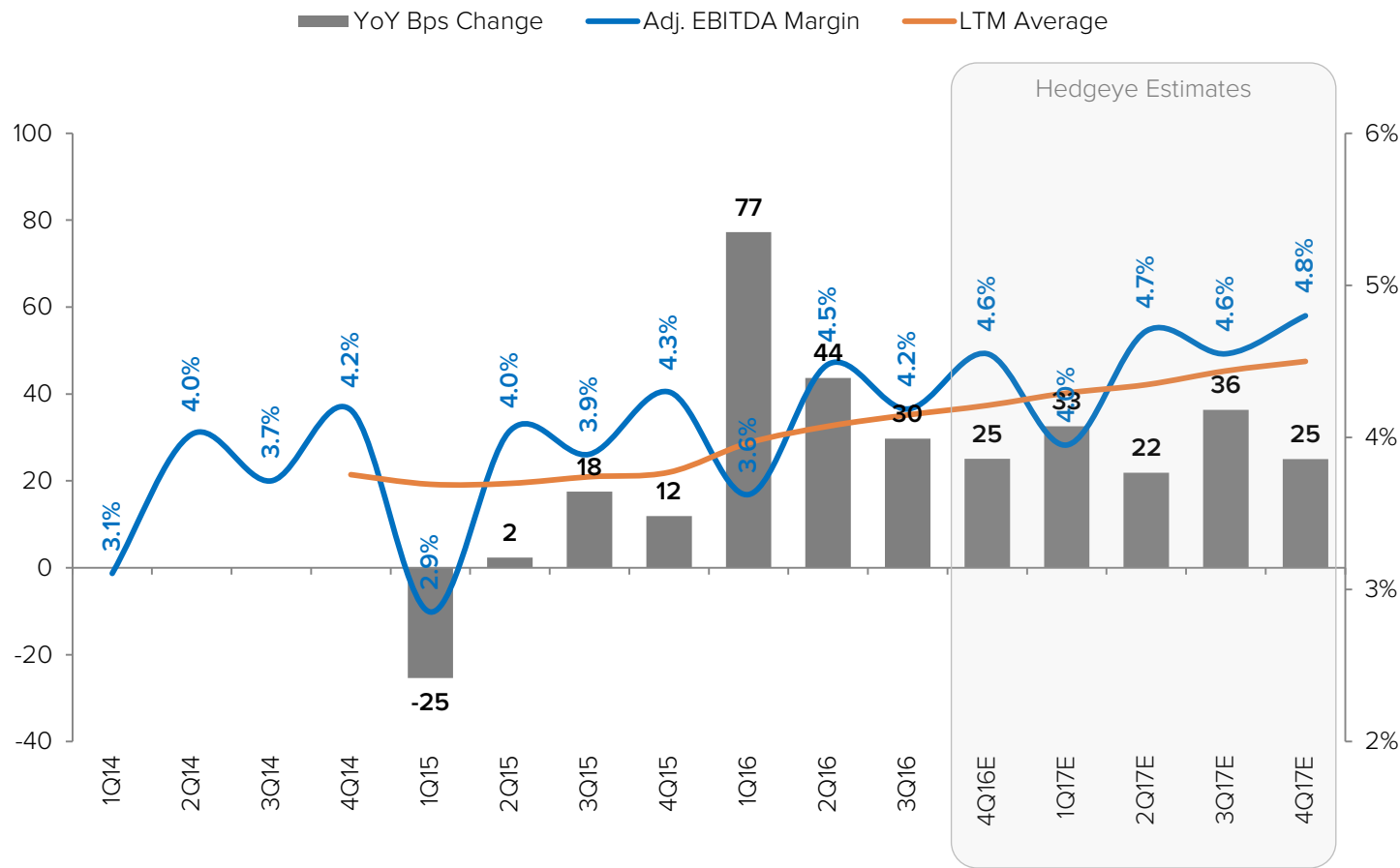
# AD. OPERATING EXPENSES AS A % OF SALES

■ YoY Bps Change    — Adj. Operating Exp. as a % of sales    — LTM Average



- Gained efficiencies across the company as well as cost savings programs will help work this number lower.

# ADJ. EBITDA MARGIN

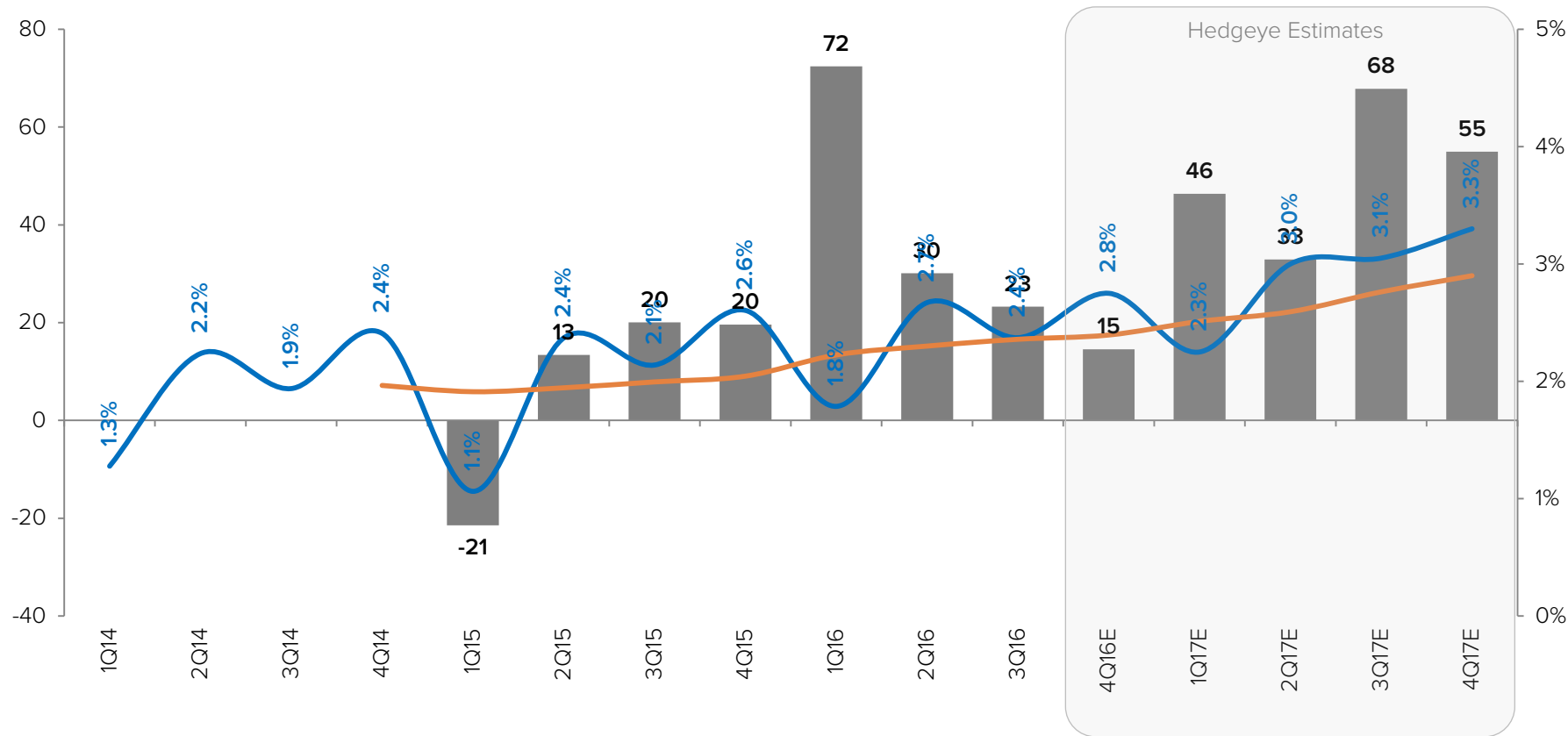


- Adjusted EBITDA dollar growth is projected to grow 7 – 10% mid-term



# OPERATING MARGIN

■ YoY Bps Change    — Adj. Operating Margin    — LTM Average

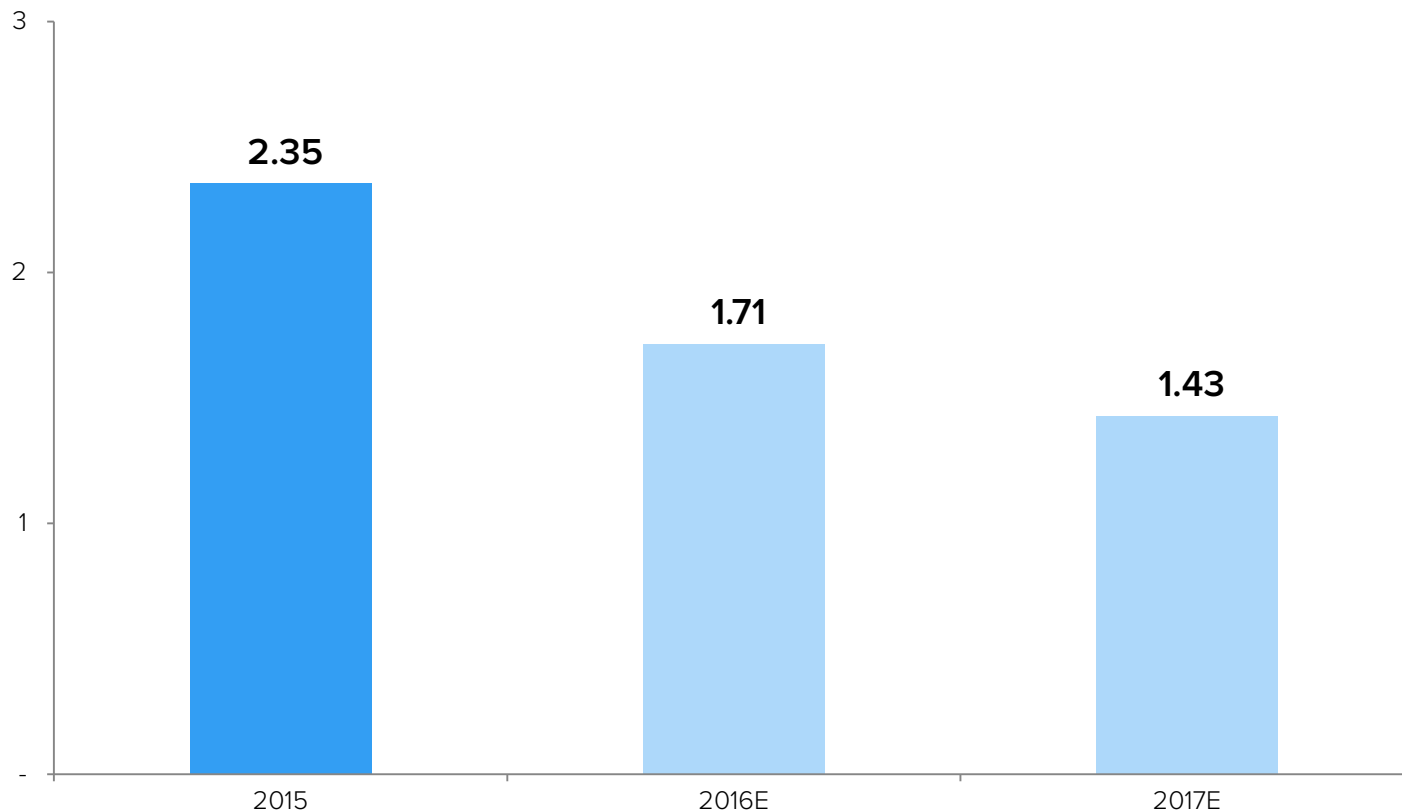




## LEVERAGE & SUSTAINABILITY

# STRONG CASH FLOW

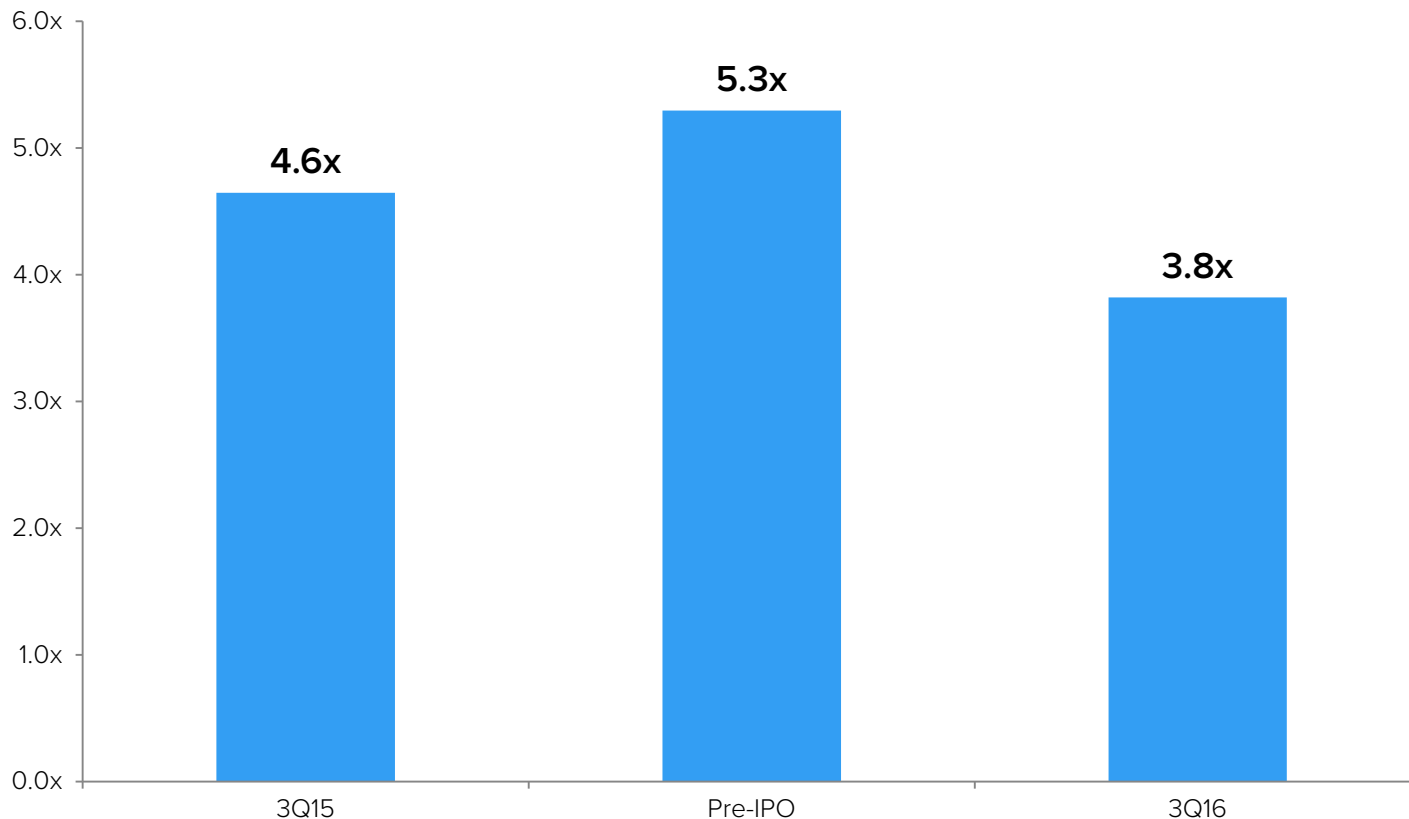
## Net CFFO/Net Income



USFD has meaningful cash flow that will enable them to pay down debt, invest in the business and participate in M&A among other activities.

# DEBT PILE SHRINKING

## Net Debt to Adj. EBITDA



- As debt gets to a lower level it opens up the options for other ways to allocate cash, such as a buy back or dividends and additional acquisitions.
- Projected to be in the 3.0x range in the mid-term.
- Average net debt to EBITDA in USFD's sub-sector is 2.9x, with SYY at 2.3x.
- Notably SYY also pays a 2.4% dividend yield, while USFD pays 0%, this is part of the reason that USFD trades at a lower multiple, and something we see changing over time as the profitability and capital structure improves.

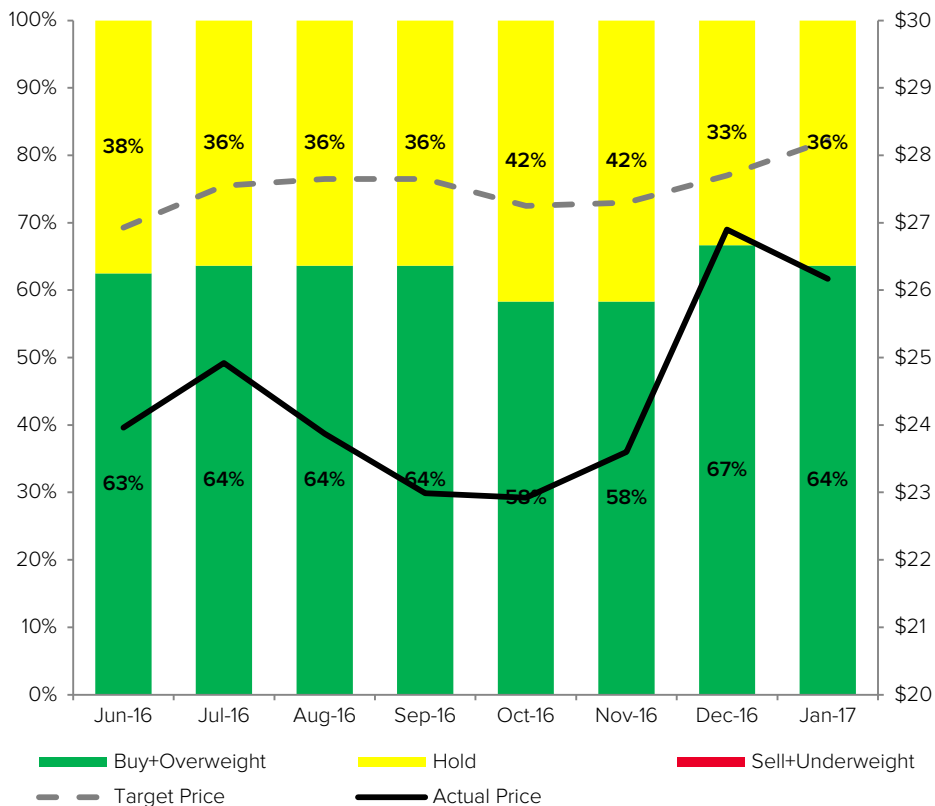


## **SENTIMENT & VALUATION**

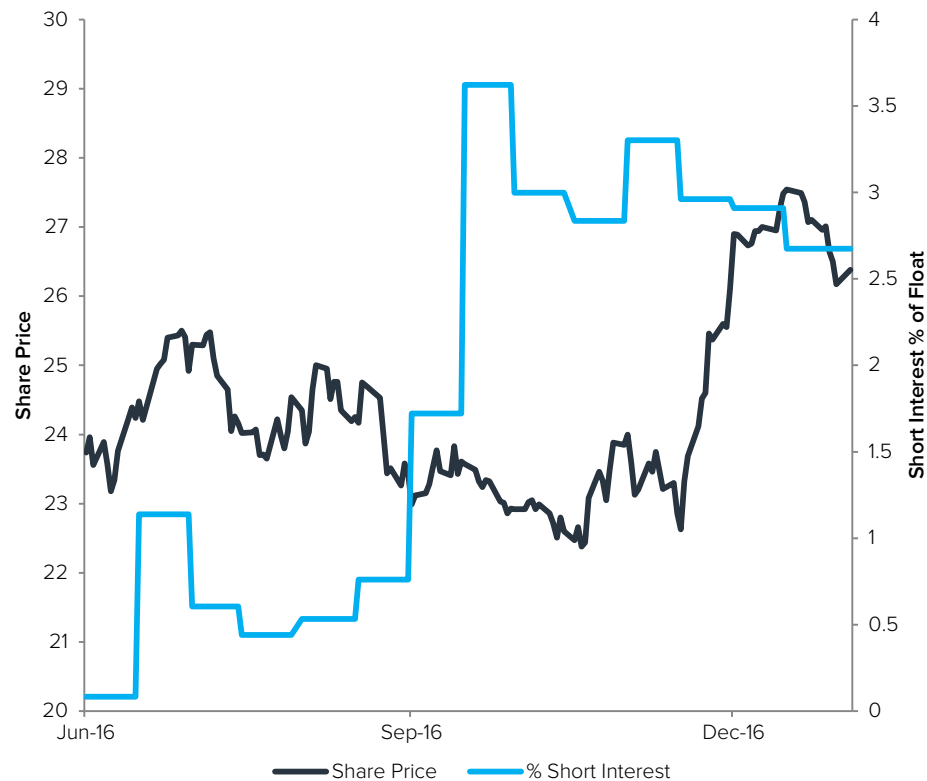


# SENTIMENT

## Sell-Side Ratings



## Short Interest



# PUBLIC COMPANY COMPARABLES

							Sentiment			Earnings				EBITDA					
Name	Ticker	Price	Shares Out	Equity Value	Net Debt	Enterprise Value	Short Interest	Dividend Yield	Analyst Rating	FY1	FY2	% Change YoY	NTM P/E	FY1	FY2	% Change YoY	EV/ EBITDA	NTM EBITDA	Net Debt/ EBITDA
Food Distribution/Wholesale																			
Core-Mark Holding Company, Inc.	CORE	\$ 42.75	46	\$ 1,973	\$ 243	\$ 2,216	5.8%	0.8	1.4	\$ 1.38	\$ 1.66	20.3%	25.3x	\$ 155	\$ 180	16.1%	12.2x		1.6x
Sysco Corporation	SYN	\$ 54.88	547	\$ 30,016	\$ 7,100	\$ 37,190	2.8%	2.4	1.8	\$ 2.45	\$ 2.71	10.6%	21.3x	\$ 3,119	\$ 3,304	5.9%	11.6x		2.3x
Chefs' Warehouse, Inc.	CHEF	\$ 15.20	26	\$ 399	\$ 306	\$ 705	7.4%	0.0	1.8	\$ 0.43	\$ 0.50	16.4%	30.3x	\$ 57	\$ 63	9.9%	11.3x		5.4x
Performance Food Group Company	PFGC	\$ 23.00	103	\$ 2,380	\$ 1,258	\$ 3,638	2.8%	0.0	1.4	\$ 1.22	\$ 1.42	16.2%	17.5x	\$ 370	\$ 406	9.5%	9.4x		3.4x
US Foods Holding Corp.	USFD	\$ 26.17	221	\$ 5,773	\$ 3,681	\$ 9,455	2.7%	0.0	1.4	\$ 1.37	\$ 1.39	1.4%	18.8x	\$ 958	\$ 1,026	7.1%	9.2x		3.8x
United Natural Foods, Inc.	UNFI	\$ 46.88	51	\$ 2,371	\$ 581	\$ 2,952	6.0%	0.0	2.0	\$ 2.56	\$ 2.71	6.0%	17.9x	\$ 323	\$ 339	5.0%	9.0x		1.8x
SpartanNash Company	SPTN	\$ 39.02	37	\$ 1,463	\$ 468	\$ 1,930	1.0%	1.5	1.9	\$ 2.14	\$ 2.32	8.3%	16.9x	\$ 230	\$ 248	7.9%	7.8x		2.0x
Average							4.1%	0.7	1.6	21.2x				10.1x				2.9x	

## Food Distribution/Wholesale

Company	Ticker	Price	Mkt Cap	1D	5D	1M	3M	6M	YTD
				% Chg	% Chg	% Chg	% Chg	% Chg	% Chg
SpartanNash Company	SPTN	39.02	1,463	-1.34	-1.49	4.16	35.63	26.52	-1.32
Sysco Corporation	SYN	54.88	30,016	-0.16	-1.44	-2.63	13.72	5.50	8.16
US Foods Holding Corp.	USFD	26.17	5,773	-1.25	-3.43	-2.71	14.18	5.02	0.00
United Natural Foods, Inc.	UNFI	46.88	2,371	-1.14	-2.13	-1.95	13.59	-2.01	-1.76
Chefs' Warehouse, Inc.	CHEF	15.20	399	-1.62	-5.00	-1.62	21.12	-7.03	-3.80
Core-Mark Holding Company, Inc.	CORE	42.75	1,973	-0.37	0.66	-0.44	21.76	-10.99	4.34
Performance Food Group Company	PFGC	23.00	2,380	-0.43	-3.97	-4.17	-6.39	-14.78	-14.53
<b>Mean</b>				<b>-0.90</b>	<b>-2.40</b>	<b>-1.34</b>	<b>16.23</b>	<b>0.32</b>	<b>-1.27</b>
<b>Median</b>				<b>-1.14</b>	<b>-2.13</b>	<b>-1.95</b>	<b>14.18</b>	<b>-2.01</b>	<b>-1.32</b>

# VALUATION MATRIX

NTM EV/EBITDA Multiple												
EBITDA	8.5x	8.8x	9.1x	9.4x	9.7x	10.0x	10.3x	10.6x	10.9x	11.2x	11.5x	
	\$1,014	\$22.38	\$23.75	\$25.13	\$26.51	\$27.89	\$29.27	\$30.65	\$32.03	\$33.40	\$34.78	\$36.16
	\$1,024	\$22.77	\$24.16	\$25.55	\$26.94	\$28.34	\$29.73	\$31.12	\$32.51	\$33.91	\$35.30	\$36.69
	\$1,034	\$23.16	\$24.57	\$25.97	\$27.38	\$28.79	\$30.19	\$31.60	\$33.01	\$34.41	\$35.82	\$37.22
	\$1,045	\$23.56	\$24.98	\$26.40	\$27.82	\$29.24	\$30.66	\$32.08	\$33.50	\$34.92	\$36.34	\$37.76
	\$1,055	\$23.96	\$25.40	\$26.83	\$28.27	\$29.70	\$31.13	\$32.57	\$34.00	\$35.44	\$36.87	\$38.31
	\$1,066	\$24.37	\$25.82	\$27.27	\$28.71	\$30.16	\$31.61	\$33.06	\$34.51	\$35.96	\$37.41	\$38.86
	\$1,076	\$24.78	\$26.24	\$27.71	\$29.17	\$30.63	\$32.10	\$33.56	\$35.02	\$36.49	\$37.95	\$39.41
	\$1,087	\$25.19	\$26.67	\$28.15	\$29.63	\$31.11	\$32.58	\$34.06	\$35.54	\$37.02	\$38.50	\$39.97
	\$1,098	\$25.61	\$27.10	\$28.60	\$30.09	\$31.58	\$33.08	\$34.57	\$36.06	\$37.56	\$39.05	\$40.54
BEAR				BASE				BULL				
-15%				19%				55%				

This is a wider range than we are used to, but we think it illustrates the opportunity that USFD and its investors have at hand. We think consensus has the potential to be a little short on EBITDA margin in the coming quarters. The improvement in profitability, coupled with margin expansion due to said improvements, will yield 30-40% of upside, with the most bullish prospects yielding 50%+ of upside.





## RISKS TO CONSIDER

# FUNDAMENTAL RISKS TO CONSIDER

## Restaurant Operator Headwinds

- There are a number of headwinds facing the restaurant industry overall
  - **Rising labor costs**, some chain restaurants disclosing that they expect labor inflation to be as much as a 5% impact in 2017
  - **Oversupply of restaurants** is driving down same-store sales growth, while real growth remains in the low single digit range
  - **Inflation** returning would also be an unwelcome headwind for restaurant operators especially those with smaller buying power
- In an environment where labor inflation is set to increase by roughly 5% in 2017 as stated by some public companies this will undoubtedly put pressure on independents. There is two sides to the coin, either some go out of business and USFD's addressable market shrinks or they become more proactive about streamlining their cost structure and go with one full service Broadline distributor like USFD, likely to be a mix of the two.

## Labor, A Two Part Story for USFD

1

- Rising labor pressures could start to impact their P&L as they are forced to pay higher wages to their employees.
- Tight labor market could also make for a scarcity of good labor in all markets.

2

- Multi-employer pension plans (MPP) picture for USFD is not a major factor, 19% of workforce is unionized.
- Participate in Central States hybrid plan in order to mitigate some risk associated with that pension.
- USFD recently paid a withdrawal liability of \$46 million when they closed their Baltimore, Maryland facility, this is equivalent to ~\$131K per employee.
- *From our prior research on KR, this withdrawal liability is above our estimate of ~\$107K per employee, and in such, spells further trouble for KR.*

# SUMMARY OF OUR THOUGHTS

## Key Points

- 1 Robust suite of initiatives to drive margin growth and share gains
- 2 Growth with independents
- 3 Debt reduction will free up capital for further investment, M&A or potentially a dividend down the road

## Risks To The Long

- 1 Insider selling will occur and needs to be taken into account
- 2 Persistent Deflation
- 3 Independent restaurants start to lag the category

FOR MORE INFORMATION, CONTACT US AT:

**SALES@HEDGEYE.COM**  
**(203) 562-6500**