INTERNATIONAL BROTHERHOOD OF TEAMSTERS

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November 2019

RE: Please Vote Against "Say-on-Pay" and Compensation Committee Chair at United Natural Foods, Inc. (NYSE: UNFI) on Dec. 18, 2019

Dear Fellow UNFI Shareholder:

Amid a 75 percent collapse in UNFI's stock price since the announcement of the Supervalu acquisition in July 2018, we urge you to Vote No on the advisory vote to Approve Executive Compensation (Item 3) and the re-election of James P. Heffernan (Item 1f) – the company's Compensation Committee Chair and former Lead Independent Director – at the annual meeting on December 18, 2019. Even as management has succeeded in destroying billions of dollars in shareholder value, the Compensation Committee, under Director Heffernan's leadership, has taken numerous steps to cushion the financial blow to CEO Steven Spinner and other top executives, including:

- ***Offering new lucrative employment contracts.*** Under new agreements in October 2018, CEO Spinner received a 63 percent increase in target pay, and COO Sean Griffin's target compensation jumped 144 percent. Retirement has also become more generous, with the company now providing for the continued vesting, rather than the forfeiture, of outstanding equity awards upon retirement.
- ***Using discretion to boost CEO Spinner's annual bonus award***. Under the pretext of controlling for a favorable non-operating boost to EPS, the Compensation Committee eliminated the EPS component from CEO Spinner's annual incentive award in its entirety, leaving the award fully dependent on adjusted EBITDA. The resulting payout was double what CEO Spinner would have received if the committee had simply removed the favorable adjustment from the EPS results, but otherwise left the EPS metric in place.
- ***Eliminating the gateway EPS requirement from the vesting of CEO Spinner's FY 2017 Special PSU award.*** Critically, without the removal of the gateway metric, Spinner would have forfeited almost half of the special PSU awards granted as part of a contract extension in FY 2017, the total value of which in FY 2017 was valued at $7.3 million.
- ***Utilizing an array of payout ranges for the same metric across a variety of incentive vehicles.*** For CEO Spinner, three incentive award components, all based on FY 2019 EBITDA and designed or otherwise adjusted to reflect the impact of the Supervalu transaction, qualified for vastly differing payout levels – 0 percent, 43 percent, and 93 percent. Mindful that FY 2019 EBITDA came in short of the company's own expectations, and that even the company admits to a challenging FY 2019, it is perplexing to see the same performance merit such wildly varying payouts, including, in one case, almost at target.

Any latent performance sensitivity there is in executive pay at UNFI is severely undermined by these practices. In fact, by almost any valuation of CEO pay, the company's three-year pay-for-performance profile ranks in the bottom three percentiles of Russell 3000 companies, according to analysis by leading

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executive compensation data, Equilar Inc.[1] Considering the board's claims to have overhauled its pay practices following the 2017 defeat of its Say-on-Pay proposal, this state of affairs is all the more troubling.

Accordingly, we urge shareholders to not only vote against the approval of the executive pay practices, but also against Compensation Committee Chair Heffernan, who has served on the committee since 2002 and as chair for the past nine years. Director Heffernan, furthermore, we believe bears central responsibility as UNFI's lead independent director from 2014 to 2019 for the board's demonstrable failure to effectively steward shareholder's capital.

The Teamsters and its affiliated pension and benefit funds have more than $100 billion invested in the capital markets and have substantial holdings in UNFI.

UNFI's Record of Value Destruction

UNFI's performance challenges have been long in the making. Even prior to the costly Supervalu deal being struck in July 2018, UNFI was significantly trailing the market, with shares underperforming the S&P500 by approximately 40 percentage points and 95 percentage points, respectively, over the prior three- and five-year periods.

Since the merger, however, UNFI's performance challenges have only accelerated, leaving it among the worst investments in the United States. After selling off 16 percent on news of the transaction, the stock has collapsed more than 75 percent (compared to a nine percent gain in the S&P500). To put the value destruction in the starkest of terms, we note that UNFI shareholders paid $1.3 billion – representing a 67 percent premium - to Supervalu shareholders (plus $1.6 billion in assumed liabilities) to go from a $2.2 billion market cap company to one with a current trading value of around $0.4 billion. Equally damning is the fact that less than six months after closing the deal, UNFI was forced to write-off almost $300 million in goodwill associated with the acquisition – the equivalent of all of the goodwill associated with the Supervalu wholesale unit, the key asset acquired.[2]

Beyond the numbers, the company's problems are exemplified by a series of visible managerial miscues including: the poorly executed financing for the acquisition itself, which has led to a nearly unprecedented lawsuit[3] against the company's lead investment bank, Goldman Sachs, along with significantly higher interest expenses; and, an integration process that is both behind schedule and experiencing significant execution difficulties. Critically, not only did the company's Q4 2019 earnings fall short of guidance, but management was also forced to walk back financial projections beyond FY 2020 - news that pushed the stock down 25 percent.

With UNFI's stock drastically underperforming its key peers over the past twelve months, it should be obvious (particularly to the board) that these challenges go far beyond difficult market conditions and intensifying competition – and not least to the execution and pricing of the Supervalu transaction. Nevertheless, Director Heffernan's Compensation Committee has taken numerous steps to cushion the financial blow to top executives.

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[1] Equilar's modeling evaluates pay against annualized TSR.

[2] In a tacit admission of the value being put at risk by the deal, the Compensation Committee lowered the ROIC target in the company's PSU awards to just 4.42 percent for 2019 (from 7.55 percent), a level significantly below the cost of capital, and even then, one that the company failed to achieve.

[3] https://www.wsj.com/articles/goldman-feasts-at-expense-of-food-company-client-suit-claims-11548884825

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Lucrative New Employment Agreements

Notwithstanding the fact the market had already, by then, rendered its disapproval of the terms of the Supervalu deal, CEO Spinner and COO Griffin benefited from huge pay raises in connection with the merger's closure in late October 2018. Even accepting that the acquisition brought broader responsibilities for these executives, the raises, at best, appear premature given the market's skepticism for the deal; at worse, they risk rewarding executive hubris and the disastrous consequences for already long-suffering shareholders.

To begin, it is worth recalling that CEO Spinner had only just entered a new three-year contract two years earlier (in October 2016). This FY 2017 agreement provided not only higher target pay, but a one-time award of 175,000 PSUs – valued at $7.3 million – and a $1.25 million cash bonus. Over the intervening 24 months, with the stock falling 48 percent, it is difficult to see anything in the company's performance meriting a further pay raise. Yet, following a review of compensation in light of the Supervalu transaction, Director Heffernan's Compensation Committee awarded CEO Spinner a 63 percent target pay raise – comprising a 27 percent increase in base salary, an increase in his target annual bonus from 100 percent of base salary to 150 percent, and a bump in his target long-term incentive award from 325 percent of base salary to 425 percent. COO Griffin, meanwhile, received a 144 percent raise in target pay for assuming responsibility of the Supervalu operations.

We appreciate that it is not uncommon for a merger to somewhat raise executive pay, as the Compensation Committee can justify populating its compensation peer group with larger competitors; however, relying exclusively on revenue to derive a peer group, without any consideration of market capitalization, risks grossly mispresenting the market for corporate talent, particularly in the case of UNFI. This was after all a $2.2 billion market capitalization company that paid $1.3 billion for Supervalu's equity, only to be now valued at $0.4 billion. Even if portions of the new target compensation failed to pay out in 2019, the contracts set a new baseline going forward; irrespective of whether shareholders ever recoup the value they have lost.

At the same time, given the performance record of this management team, we see no reasonable justification for shareholders to concur with the Compensation Committee's decision to sweeten the terms of executive retirement – going forward, outstanding equity awards will vest into retirement, rather than be subject to forfeiture as was previously the case. It is conceivable that more generous terms might be necessary to attract new talent to the company, but in applying this change to current executives, we believe the Compensation Committee grossly misconstrues the labor market competition for its current management team.

Positive Discretion Used to Boost CEO Spinner's Annual Bonus Award

The company claims to have "exercised negative discretion" with respect to CEO Spinner's annual bonus, but the results of the adjustments to the annual incentive award is the precise opposite: the payout was double what it ought to have been based on results.

At the heart of the matter is the fate of the EPS component of the annual incentive award -- originally to comprise 50 percent of the payout target for CEO Spinner (and COO Griffin), with the other half to be based on adjusted EBITDA. The proxy notes that the adjusted EPS was positively impacted by an $80 million purchase accounting adjustment, which, if included, would have resulted in the EPS component paying out at 200 percent – a level that the Compensation Committee rightly adjudged to be inappropriate. However, rather than adjusting the EPS results to exclude the positive impact of the accounting adjustment, the Compensation Committee elected to eliminate the EPS component of the award entirely, rendering the award fully determined by the adjusted EBITDA performance, which qualified for a 43 percent payout.

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Critically, based on our calculations (the reconciliation tables in the proxy do not fully disclose the adjustment), neutralizing for the positive impact of the accounting adjustment would have resulted in an adjusted EPS that was below the threshold level (~$1.28 vs. $1.58). In other words, by rebasing the award entirely on adjusted EBITDA, rather than blending with the EPS portion of the bonus, the payout was double what it ought to have been at $760,000, or 43 percent of target. This is nothing short of positive discretion under the guise of applying negative discretion.

Removal of Gateway EPS Requirement for CEO Spinner's Special 2017 PSU Award

Again, under the pretext of doing the right thing – avoiding a payout that was not reflective of operational performance – the company gifted CEO Spinner with payouts by eliminating unfavorable performance requirements tied to his FY 2017 special PSU grant, an award that was at the center of the 2017 Say-on-Pay defeat.

We note that under the terms of the special PSU award – valued at $7.3 million upon granting -- the company had to achieve a minimum $1.00 in GAAP EPS before the units could vest based on net sales and adjusted EBITDA performance. Nearly half of the special grant – 75,000 of the original 175,000 units – was contingent, at least in part, upon FY 2019 performance, and thus achieving at least $1.00 in GAAP EPS in the past fiscal year. As it turned out, the company posted a GAAP EPS loss of $5.56 per share – a result nearly equal to the combined earnings per share of the two prior years. Critically, however, in addition to correctly raising the adjusted EBITDA and net sales targets to reflect the additional Supervalu business, the Compensation Committee determined to also eliminate the gateway GAAP EPS requirement. With the awards ultimately vesting at around target based on net sales and adjusted EBITDA, the decision to eliminate the gateway GAAP EPS proved extremely lucrative to CEO Spinner.

The company insists that with the Supervalu transaction, the gateway measure was no longer "reflective of operational performance," but it glosses over the fact that much of the loss stemmed from the almost immediate write-down of the goodwill associated with the Supervalu transaction – a move that speaks directly to management's missteps in valuing and/or executing the deal in the first place. Moreover, while it is conceivable that GAAP EPS could understate the value management is creating for shareholders, and that even a relatively low-bar of $1.00 is no longer appropriate, this is a stretch at UNFI where, over the lifetime of the award, the stock has fallen more than 80 percent. In fact, with the earlier tranches of the award vesting at around target, it is far more likely the case that the net sales and adjusted EBITDA targets were set inappropriately low.

Shareholders were right to object to these awards in 2017. Given the discretion used to facilitate their vesting in 2019, we believe they are right to do so again.

Poorly Structured Incentive Vehicles Cash out at Vastly Different Levels for Same 2019 EBITDA Performance

With consistency in target setting core to effective incentive compensation, it is profoundly troubling that for CEO Spinner three incentive vehicles, all tied to FY 2019 EBITDA, paid out at wildly divergent levels, despite all having been designed or adjusted to reflect the Supervalu acquisition.

We note that the annual incentive portion tied to FY 2019 EBITDA paid at the 43.5 percent level;[4] the FY 2019 EBITDA component of the 2018 PSU grant (based entirely on fiscal 2019 performance) came in below

[4] As discussed above, the original award for CEO Spinner was to be weighted evenly between adjusted EPS and adjusted EBITDA performance.

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threshold EBITDA performance;[5] and the FY 2019 tranche of the FY 2017 Special PSU grant to CEO Spinner vested at the 93.4 percent level based on FY 2019 EBITDA,[6] while the tranche tied to 3-year cumulative EBITDA (2017-2019) qualified for a 97.0 percent payout.

While we acknowledge that the three awards set their respective FY 2019 EBITDA targets at different time, the wide-range in payouts is disconcerting – what reward did FY 2019 performance actually merit? Most concerning to us is the fact that despite being adjusted for the Supervalu transaction, and in spite of a disappointing FY 2019, the FY 2017 Special PSU tranches paid out close to target. This strongly suggests to us that the performance target and threshold level were insufficiently robust in the first place (see Table 1).

Table 1: Award Payout Schedules and Results based on FY 2019 EBITDA

	Threshold Performance*	Target Performance*	Stretch Performance*	Actual Performance*	Qualifying Payout Based on adj. EBITDA**
FY 2019 Annual Incentive	$578,600	$657,500	$736,400	$588,900	43.5%
FY 2018 PSU Award	$625,986	$662,490	$698,993	$588,900	0%
FY 2017 Special PSU Award	$491,311	$637,168	$656,283	$588,900	93.4%

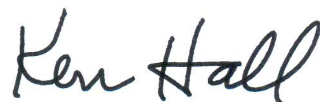
*Adjusted EBITDA in 000s; ** Payout level of the adjusted EBITDA portion of the award.

Vote Against Say-on-Pay and Re-election of Heffernan

Despite multiple years of declining performance under Director Heffernan's leadership, the Compensation Committee has taken numerous steps to cushion the financial blow to CEO Spinner and other top executives. Considering that the committee claims to have reformed pay following the 2017 Say-on-Pay defeat, the latest actions raise serious concerns over Director Heffernan's effectiveness as the committee chair. Moreover, until recently, the lead independent director, Director Heffernan bears considerable responsibility for the board's failure to effectively steward capital, particularly with the costly acquisition of Supervalu. **Accordingly, we urge shareholders to not only vote against the advisory vote to approve executive compensation, but also Director Heffernan's re-election to the board.**

For more information, please contact Michael Pryce-Jones, Capital Strategies Department, at mpryce-jones@teamster.org or 202-624-8990.

Sincerely,



Ken Hall
General Secretary-Treasurer

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[5] The FY 2018 LTI award was based on a matrix of five levels of adjusted EBITDA and ROIC performance, with a +/- 10 percent TSR modifier. The adjusted EBITDA component came in below threshold, while the ROIC performance qualified for a 5.3 percent payout.
[6] The award was equally weighted between adjusted EBITDA and net sales.

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