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Performance Food Group Co. (PFGC)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

William S. Marshall
Vice President-Investor Relations, Performance Food Group Co.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

OTHER PARTICIPANTS

John Heinbockel
Analyst, Guggenheim Securities

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Alexander Slagle
Analyst, Jefferies LLC

Kelly Bania
Analyst, BMO Capital Markets Corp.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Mark Carden
Analyst, UBS Securities LLC

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Joshua C. Long
Analyst, Stephens, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to PFG's Fiscal Year Q3 2023 Earnings Conference Call. [Operator Instructions]

I would now like to turn the call over to Bill Marshall, Vice President of Investor Relations for PFG. Please go ahead, sir.

William S. Marshall
Vice President-Investor Relations, Performance Food Group Co.

Thank you and good morning. We're here with: George Holm, PFG's CEO; and Patrick Hatcher, PFG's CFO. We issued a press release regarding our 2023 fiscal third quarter results this morning, which can be found in the Investor Relations section of our website at PFGC.com.

During our call today, unless otherwise stated, we are comparing results to the same period in our 2022 fiscal third quarter. As a reminder, in the second quarter of fiscal 2022, we changed our operating segments to reflect how we manage the business.

The results discussed on this call will include GAAP and non-GAAP results adjusted for certain items. The reconciliation of these non-GAAP measures to the corresponding GAAP measures can be found at the back of the earnings release. As a reminder, in the fiscal first quarter of 2023, we updated our segment reporting metrics to adjusted EBITDA from the prior EBITDA metric. Accordingly, the segment results for the third quarter of 2022 have been restated to reflect this change.

Our remarks on this call and in the earnings release contain forward-looking statements and projections of future results. Please review the cautionary forward-looking statements section in today's earnings release and our SEC filings for various factors that could cause our actual results to differ materially from our forward-looking statements and projections.

Now, I'd like to turn the call over to George.

George L. Holm

Chairman & Chief Executive Officer, Performance Food Group Co.

Thanks, Bill. Good morning, everyone, and thank you for joining our call today. I'm excited to speak to you today about our fiscal third quarter results and outlook for the remainder of the fiscal year. Once again, our organization executed at a high level, producing strong financial results. Sales growth in high quality channels and disciplined cost control drove double-digit profit growth and very strong cash flow in the quarter. This allowed us to invest behind growth initiatives and pay down debt, preparing us for the future and improving an already strong balance sheet position.

In June, we laid out three key strategic priorities: consistent profitable top line growth; adjusted EBITDA margin expansion; and leverage reduction. I am pleased with how our organization has internalized these initiatives and made rapid progress on all three. We are achieving these goals with contributions from each of our three reportable segments. In a moment, I will highlight the success of each in these units and discuss why we believe we are well-positioned to grow our business and deliver significant shareholder value over the long-term.

As you saw in our press release this morning, our adjusted EBITDA in the fiscal third quarter was once again ahead of our guidance. As a result, we are raising and tightening our adjusted EBITDA guidance range for the full year. In a moment, Patrick will provide additional details on our financial performance and outlook.

Our financial success in the fiscal third quarter was achieved despite decelerating inflation in the Foodservice business. Over the long-term, we believe normalized inflation is healthy for our company, our customers and consumers, and look forward to a period of stable, low single-digit inflation. This will bring back the market to a more typical operating condition.

In the meantime, we have been able to offset a lower inflation benefit through market share gains within highly profitable channels, rapid growth in high margin products and disciplined cost controls. We're very pleased to see our organic volume growth accelerate in the fiscal third quarter. This reflects strong market share gains in the independent restaurant channel, solid growth at Vistar and consistent progress selling food and foodservice into the convenience channel. It is not a coincidence that each of these areas are also where we generate the highest returns, best profit margins, and significant operating cash flow.

There are several factors helping our improved volume performance. In addition to our typical best-in-class sales and service levels to customers, we continue to see a tailwind from improving inbound and outbound fill rates, particularly at Vistar and Convenience. Foodservice fill rates are essentially back to normalized pre-pandemic levels. As fill rates at Vistar and Convenience continue their steady march forward, we would expect it to support further volume gains.

Let's review several highlights from each of our reportable segments, and then I will provide my thoughts on the current environment. As I mentioned earlier, we were very pleased with the progress in our case growth during the fiscal third quarter. In Foodservice, this was led by our independent business, which saw organic case growth of 8.3% year-over-year. Some of the outperformance was certainly due to the benefit of an easier comparison due to the Omicron impact early in the third quarter of last year. However, we were encouraged by the resiliency of independent case growth in March, when comparisons were much more difficult.

As we discussed in the past few earnings calls, our independent case growth has been driven by new accounts, more so than increased penetration in existing accounts. This trend continued, to a large extent, in the fiscal third quarter, though we did see an increase in cases per account year-over-year. With that said, new account growth was even faster in the fiscal third quarter than it had been in the prior two quarters and was just behind total case growth.

Rapid growth in total new accounts, coupled with year-over-year increases in cases per account, should be a strong combination for our case growth in future periods. This is also reflected in our market share momentum, which remains robust. Our data shows consistent market share improvement in the independent channel, both on a case and dollar basis.

As you know, we define an independent restaurant as an operator with fewer than five locations. We have remained consistent in this definition.

We are very pleased with the progress the Foodservice team has made with our independent restaurant business, which goes beyond the headline case growth numbers and includes solid factors underpinning that growth, which we believe will produce long-term gains. This is not only profitable to our bottom line, but good for the long-term positioning of our Foodservice segment.

Moving to Vistar, the segment has continued to perform well over the past several quarters. The third fiscal quarter of 2023 was no exception, as Vistar reported nice revenue gains and adjusted EBITDA growth versus the prior year period. Vistar's success was broad-based, with double-digit case growth in vending, office coffee, theater and concessions. There are several factors driving this success, including continued recovery in several of these channels, as consumers increasingly revert to their pre-pandemic behaviors.

We're also seeing a nice lift from improved fill rates, as I mentioned in my earlier remarks. This is encouraging as the benefit was already being recognized, despite fill rates still below historic levels. As the supply chain moves closer and closer to healthy fill rates, we expect the case and dollar sales lift to persist.

Vistar is an important growth area for PFG, not only contributing to our sales momentum, but also accretive to our profit margins and returns. We are optimistic that Vistar will benefit from the combination of continued channel recovery and organic growth into existing channels, along with entry into new channels.

Our push into the convenience channel continues unabated, with another quarter of double-digit Foodservice sales growth. We are particularly pleased with the pace of profit growth in Convenience, driven by strong results from higher margin products, along with like-for-like margin improvement across both nicotine and non-nicotine businesses.

As we have discussed with you in the past, the sales cycle for the Convenience business tends to be long. However, we have a stable pipeline of new business opportunities, which we expect to drive sales and profit growth over the long term and produce nice shareholder returns on our investment in Core-Mark.

Before turning it over to Patrick, who will provide additional detail on our financial results, I wanted to briefly discuss the recent inflation trends. As expected, we have seen inflation rates move lower month-by-month. On a consolidated basis, the pace of disinflation has been roughly in line with our model, which is the basis for our guidance. However, there has been divergence segment-by-segment. Inflation in Foodservice has fallen quicker than anticipated, while Vistar and Convenience have continued to experience persistently elevated year-over-year inflation rates.

We feel very comfortable with our businesses' ability to manage through the environment, demonstrated by our strong third quarter results. Over time, we would expect Foodservice inflation rates to stabilize in a more normal low single-digit range, with Vistar and Convenience inflation rates beginning to move lower over the next few quarters.

In summary, all three of our reportable segments had an excellent start to the calendar year, finishing our fiscal third quarter with strong volume momentum, favorable profit mix and tight cost controls. This led to a strong bottom line result, very solid cash flow generation and continued progress fortifying our balance sheet.

I'll now turn the call over to Patrick, who will provide additional detail on our financial performance and outlook for the future. Patrick?

Patrick Hatcher

Chief Financial Officer & Executive Vice President, Performance Food Group Co.

Thank you, George, and good morning, everyone. As George discussed, we had an outstanding fiscal third quarter, making progress on our three main objectives and putting our business in a position to drive shareholder value over the long term. Once again, our adjusted EBITDA result came in above our guidance, resulting from better than anticipated gross profit performance and tight operating cost controls. As a result, we are raising and tightening our full year adjusted EBITDA guidance range. I will walk through our guidance in more detail shortly.

We are also very pleased with our organization's ability to convert these profit results into cash flow. Operating cash flow generation provides us the flexibility to invest behind value-creating growth projects, which we believe will produce sustainable revenue growth in the years ahead. Meanwhile, we have used our excess free cash flow to reduce our outstanding debt on our ABL revolving credit facility. That, coupled with our adjusted EBITDA growth, moved our leverage to the midpoint of our target range.

Let's walk through a few specifics on our cash flow and leverage. Through the first nine months of fiscal 2023, PFG generated $657.2 million of operating cash flow. After accounting for $177 million of capital expenditures, PFG generated $480 million of free cash flow over the past nine months. We are very pleased with this cash flow result, which reflects strong cash generation during the fiscal third quarter.

Our operating and free cash flow is up significantly compared to the prior year in both the three and nine-month periods. This is a testament to our strong underlying fundamentals, along with disciplined working capital management.

We have also stepped up our capital expenditures to match the current and future growth prospects of our organization. Much of this spending goes towards building new capacity to support long-term growth across all three reportable segments. These facilities are equipped with updated equipment and technology, making our business more efficient, in addition to supporting our rapid growth.

Over the past nine months, we paid down our ABL facility by about $380 million. As a result, at the end of the third quarter, our leverage ratio was 3.0 times net debt to adjusted EBITDA on a trailing 12-month basis. Our leverage is now right at the midpoint of our 2.5 to 3.5 times target range.

At the end of our fiscal third quarter, about 79% of our outstanding debt was at a fixed rate, including swaps we have in place against a portion of our floating rate ABL facility. We believe this is a very healthy position, particularly given the interest rate environment today. We expect to continue to manage our leverage within our target range, while keeping optionality for potential M&A and other value-creating activities.

I want to take a moment and update you on our digital ordering platform, Customer First. As a reminder, Customer First is our new digital platform designed to provide customers across our businesses with a better online ordering experience. We have made significant progress in the rollout. At this time, 90% of Foodservice locations are in some stage of deployment and 100% of Vistar locations have access to Customer First. We expect this platform to result in increased order sizes, improved customer retention, and generate new business wins. It also leverages the entire PFG platform and is expected to generate cross-selling opportunities. Feedback from the customers using the platform has been very positive and we continue to convert accounts.

PFG has expertise across food-away-from-home channels and Customer First allows our organization to unleash that potential. We are very excited about the progress we have made and expect much more to come.

With that, let's quickly review some highlights from our fiscal third quarter. PFG total company net sales increased 5% to $13.8 billion. Our net sales performance was driven by strong case growth, somewhat impacted by lower levels of year-over-year inflation in Foodservice. Total organic case volume increased 3.1% in the third quarter, driven by growth of independent restaurants, Performance Brands, as well as gains in Vistar. Our total case growth was an acceleration from the prior two quarters, when organic cases were flat for the total company year-over-year.

Organic independent cases were up 8.3% in the fiscal third quarter, again, an acceleration from the prior two quarters, when organic independent case growth was in the mid-4% range. Outperformance in independent case volume continues to reflect market share gains and new business wins in that important high-margin business.

Total PFG gross profit increased 12% compared to the prior year quarter. Gross profit per case was up about $0.55 in the third quarter compared to the prior year period. In the third quarter, PFG reported net income of $80.3 million and adjusted EBITDA increased 32% to nearly $315 million.

Inflation continues to impact our business and continued to moderate due to lower year-over-year inflation in the Foodservice segment. Total company cost inflation was 7.2% in the quarter. This was the first period with single-digit inflation since the first fiscal quarter of 2022. The deceleration was driven by our Foodservice segment, which experienced 3.5% inflation in the fiscal third quarter. Vistar inflation remained at the mid-teen level in the quarter, while Convenience experienced another quarter with inflation just above 10%. Once again, inflation for both Vistar and Convenience were very similar to what they experienced in the prior two quarters.

As George mentioned, we continue to expect lower levels of inflation through the remainder of fiscal 2023, which is the assumption embedded in our outlook. As we have discussed on prior calls, decelerating inflation produces a short-term headwind from inventory holding gains. In the fiscal fourth quarter of 2023 and the fiscal first quarter of 2024, holding gain comparisons will be elevated. With that said, our track record of offsetting this impact over the prior two quarters gives us confidence in our ability to manage through it. Once we reach fiscal second quarter of 2024, the comparisons ease substantially.

Total company third quarter adjusted EBITDA margins increased 47 basis points compared to the prior year period. We remain very pleased with our ongoing margin improvement, demonstrating our organization's commitment to strong profit results, despite challenges related to lower levels of inflation. Diluted earnings per share was $0.51 in the third quarter and adjusted diluted earnings per share was $0.83.

As you saw in our earnings release, we have tightened our full year 2023 revenue outlook and raised and tightened our full year adjusted EBITDA range. For the full year, we now anticipate net sales in the range of $57 billion to $57.5 billion. This range incorporates our strong case growth momentum, somewhat offset by lower levels of year-over-year inflation. Adjusted EBITDA now is anticipated to be in the range of $1.34 billion to $1.36 billion, an increase from our prior $1.27 billion to $1.35 billion range. This 2023 expectation keeps us on track to achieve our three year fiscal 2025 target we set at our June Investor Day.

To wrap up, we are very encouraged by our third quarter results, which saw continued progress on our three focus areas: sustained profitable sales growth; adjusted EBITDA margin expansion; and lower leverage, despite challenges in the external environment. We generated significant operating and free cash flow, which allowed us to pay down debt and move to the midpoint of our leverage target range.

Our organization is executing our strategy. And we believe we are well-positioned to continue to create value for our shareholders over the long term.

Thank you for your time today. We appreciate your interest in Performance Food Group. And with that, we'd be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we will take our first question from John Heinbockel with Guggenheim Securities. Your line is now open.

John Heinbockel
Analyst, Guggenheim Securities

Q

Hey, George, I want to start with the sales force, right, and the share gains. Because I think you disclosed at CAGNY, right, the sales force growth is into the low double digits, which I don't think we've ever seen before. So maybe talk about that effort. Do you think that industry demand softens from here? And then, does that sort of give you confidence that because of what you've done with sales, you can sustain, let's say, a mid-single-digit or better growth in independent cases, even in a slowdown?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. Look, we're quite confident. And adding the salespeople, I think, was a big key for us. We've been real consistent on our increase in customers over the previous year, all through this year. 6% to 7% is about where we've been running. And we've had inconsistent month-to-month sales growth. So the way we look at it is that we're in a pretty consistent mode right now. And the variability that we have kind of week-to-week, month-to-month in sales growth is all macro. And if you look at the quarter that we just finished, we had extremely strong January because of light comparisons to Omicron. February, certainly not as good as January, but good. It softened some in March. I think that was some cabin fever last year and just a real strong March last year.

But that consistency of the 6% to 7% growth in number of customers held all the way through that period of time. We've also seen that so far in this quarter. We have kind of an odd calendar mismatch, where, last year, we had Cinco de Mayo, which is real big for us, and Mother's Day, which, of course, is big, the same week last year. So, this week that we're in right now, we're running unusually high growth. But I think it's just because we're up against the week after Mother's Day and we have Mother's Day.

So, it's hard to comment on this quarter, but the consistency is around that continued increase in number of customers. And our hope is that that number continues to kind of be stable, where it's at now. And I think we're headed for maybe a more normal macro market and we should be able to match that customer growth with case growth.

John Heinbockel
Analyst, Guggenheim Securities

Q

Okay. And then, maybe follow-up to that, right. So, you know, one of the things that has to happen here, I think, if inflation moderates and the top line moderates, labor, right, productivity's got to pick up and the labor drag has to get better. Some of that's, I guess, natural. But where are we on that process? And do you think we're at a point here where labor productivity gets substantially better in the next three to six months?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

I think it'll continue to get better. I don't know that we'll get back to pre-COVID numbers or not. We're certainly not there yet, but it does get better and it gets better on a very consistent basis. You know, for us, we've had kind of a lull, if you look at it. We've really had a lull in case growth for normally where we're at, and that's because our national account business continues to be negative from a case growth standpoint. And I think it gave us some time to get stable, get our workforce more stable. And we feel like we're positioned to continue to get better productivity and, hopefully, with that, get better growth as well. But the labor market is improving.

John Heinbockel
Analyst, Guggenheim Securities

Q

Okay, thank you. It is improving?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yes, it is.

John Heinbockel
Analyst, Guggenheim Securities

Q

Okay. Thank you.

Operator: We will take our next question from Edward Kelly with Wells Fargo. Your line is now open.

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning, guys. Nice quarter. I wanted to start on gross profit per case, up $0.55. You know, it's still very impressive, despite lapping inventory gains, what looks like actually in Foodservice, it seems like there's some maybe sequential deflation in Foodservice. I was just hoping that you could unpack the drivers of this. Is there still any unusual inventory gain running through these numbers? I know you always have some inventory gains in some of these businesses, but what you would classify as unusual. And then, how are you thinking about the outlook for gross profit per case in the coming quarters against all this?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. The inventory gains last year in that fiscal Q3, we had a very good quarter for inventory gains. We made some wise buys; was particularly in Convenience and Vistar. And we were able to overcome that through just increased gross profit per case and some growth. That number gets bigger in Q4. And then in Q1 of next year is when it peaks and then it normalizes after that.

So we're cautious around those quarters because of the amount of those gains. But, of course, the quarter that we just finished gives us a lot of confidence going into that. We will have somewhat of a – when I think – when we get our budget together and our guidance together for the August call, we'll probably present something that looks a bit like a hockey stick, where this year we were a reverse hockey stick. But we look at where we sit today and we have a lot of long-term confidence.

As far as gross profit per case goes, a lot of our increase in gross profit per case is mix related, both channel mix and customer mix. Anytime we have our independent growing at such a significant amount more than our national account business, we're going to increase our gross profit per case. And Vistar, that they've just been real consistent with that increase. And then, we have that fulfillment business where we don't have the revenues. All we have is that gross profit per case, and that has some unusual effects on the business, but, for the most part, positive.

I don't see a great deal of upside in our gross profit per case. I think that our profit per case will get better as we see better productivity. But we made some significant gains there and I don't see these $0.50, $0.55 gains per case as we get into next year.

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Q

That's helpful. I guess maybe just a follow-up to that, George, you reiterate the fiscal 2025 outlook today. I think investors are kind of taking a step back and they're looking at what they think is some slowing in industry demand, a pretty sharp slowdown of inflation trends. And your outlook implies about maybe at the midpoint 8% kind of EBITDA growth over the next couple of years. And I think there's some concern in the ability to achieve that against that backdrop. Can you just maybe talk about your confidence in the ability to do that? And I know it's early on 2024, but is there any like 2025 weighting to that? Just any thoughts that you can provide maybe to give investors a little bit of comfort around that.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Well, we feel we're trying to be pretty cautious around the macro. I would call us confident around that, the range that we've given today, unless there was just something really unusual from a macro standpoint.

We've got a real good sales funnel, as we mentioned, in the convenience area. It's a long sales cycle, but we have a particularly good funnel there. And we've been fairly quiet as far as pursuing national account type of business. And we'll be a little bit more aggressive there now that we feel like we've got our arms around the labor and we have a pretty good idea of what our cost structure is going to like moving forward. And we're hopeful that we can get – we don't have anything large from an M&A standpoint that we're looking at right now. But we're hoping that we can get a little bit of M&A in there as well. So, all those things put together, I think we're pretty confident. You might want to comment on that, too.

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah, Ed, I'll just jump in. I mean, as you mentioned, we did reiterate our three year guidance. And, as George has just mentioned, we do really expect inflation to normalize. And I would call out the things that we called out in Investor Day, our strategy is working. We are expanding margin. We're reducing leverage. We're growing sales. So, we feel confident that that range that we've given for the three year guidance is absolutely something we can still hit. And where we're growing, we're showing really quality earnings, again with independent restaurants, Vistar, Foodservice and Convenience. So, we feel good about certainly the 2025 targets.

Edward J. Kelly
Analyst, Wells Fargo Securities LLC

Q

Great. Thanks, guys, appreciate that.

Operator: We will take our next question from Alex Slagle with Jefferies. Your line is open.

Alexander Slagle
Analyst, Jefferies LLC

Q

Thanks. Congrats on all the success. Just a question on the assumptions for the fourth quarter reflected in the guidance update and I guess how much of the more modest revenue outlook at the midpoint kind of comes from the lower Foodservice inflation versus lower tobacco sales view or other dynamics there? And is the Foodservice inflation, is that actually flipping just slightly deflationary in the 4Q or is it still up a bit?

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

You know, I think we'll both, both Patrick and I, will comment on that. Your comment with tobacco area, that's certainly going to continue to be soft and they're very large revenues there. We feel that that will be the case, but we also feel that our Core-Mark division will continue to manage their way through that.

The inflation residing, I guess, going to really some deflation in Foodservice is part of it. And then there's a third component. And that's that we're modeling our national account customers, in aggregate, to be soft. And they're continuing to run low single-digit negative cases. And we don't want to model anything that shows that any different. So I would say that would be the things around the revenue area.

I want to comment a little bit more on inflation before I turn it over to Pat. But like a lot of things with us, we have such a varied customer mix, that the inflation has come at different times. So in Foodservice, we're actually running much better case growth than sales growth right now. We think that will turn back around and we'll start running moderate inflation. And that hit's pretty immediate.

When you get to our national account business and particularly the big casual dining chains, the inflation hit later there. They all have different cycles, but they tend to lock pricing in for fairly lengthy periods of time, so that inflation came choppy. Some of it was fairly soon, depending on their cycle. And when that's going to go away is when they go through that next cycle and then we expect that to be just low single-digit type.

Customized, where a lot of the dollars are in the tobacco area, obviously, that's going to show continued inflation, pretty regular price increases. And everything else has been through, in some cases, an additional price increase. In some cases, they just moved up when they normally do a price increase. And as we get to a normal environment and we start to lap those increases, I think we'll see that come down to kind of low single-digit.

And then even within all that, okay, which is complicated enough, we've had such a mix change in our Foodservice business, where our business has just moved more and more towards higher case cost products. And our cheese business has been particularly robust, as has our center-of-the-plate business. So, a lot of moving parts, but we think things are eventually going to look a lot like they did pre-pandemic.

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah. I'll just make a couple quick comments. I mean, again, we're really excited about our ability to raise guidance this morning. We've done this periodically throughout the year. And we're really positive about where we're growing our business, again, independent restaurants, Vistar, Foodservice and Convenience. But I'll say, when it comes to our guidance for Q4, I mean, as George just described, we do have some headwinds, specifically what's going on with inflation and then that year-over-year inventory gain. And then, there's just the macroeconomic concerns out there. So, I think we're just being prudent with the guidance.

Alexander Slagle
Analyst, Jefferies LLC

Q

That makes sense. Yeah. And all the mix benefits have been really impressive. Wanted to ask on the Convenience business, Core-Mark, and any commentary there on the new business pipeline, any kind of surprises this continues to build and maybe expected timing of when maybe to see some new business come online.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

I think that when we get to August, will be a better time for us to comment on that. What I will say is that we feel real good with it. We – once again, long sales cycle. We have some things that we feel are actionable. We've got to get some capacity in for some of it, physical capacity. And I think we'll have a little bit more comments when we get to August. But thanks for the question. It was a great question.

Alexander Slagle
Analyst, Jefferies LLC

Q

Yeah. Thank you.

Operator: We will take our next question from Kelly Bania with BMO Capital Markets. Your line is now open.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

Hi. Good morning. Thanks for taking our questions. I guess I had two questions, both on Vistar and Convenience, for those two segments. One, can you just help us understand the magnitude of the volume or case growth you still see from service levels just normalizing back to maybe typical levels? And can you just help us be a little bit more clear on the magnitude of the inventory gains that you'll be cycling in the coming quarters for those channels as well?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah, I'll start with the service levels. They've continued to be well below pre-pandemic. They are both businesses, in Vistar and Convenience, where you don't necessarily lose the sale. They may put another SKU in there. So that's not necessarily the case. So it's hard to determine what benefit we're getting as the service levels – or fill rates get back to normal.

The other thing is that many suppliers reduce the number of SKUs that they offered during that period of time. And we are starting to see some of that come back, which we feel could help sales. But once again, they just didn't leave a slot open because something wasn't available. They put something in there. So I think that's probably real hard to determine.

As far as inventory gains and what they were, we really would prefer not to get into that level of detail, because we don't want to be in that level of detail forever. Inventory gains are part of our business, particularly in Convenience and in Vistar. And it can be a significant part of the profit that we get from certain product areas, because that's the time when it's – when you produce your profit. Otherwise, you're just moving cases.

Pat, I don't know if you have any other comments with that.

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah. Kelly, I'll just refer you back to our Q1, when we had a beat. We did say on the call that the inventory gains helped, but they were not the majority of the beat. So I'll just refer you back to that quarter.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

Okay. That's helpful. And I guess just maybe another question on inflation, a lot of investor questions on inflation; presume it's falling quicker the Foodservice side of the business, because of the fresh categories and the exposure there, versus the more shelf-stable categories at Vistar and Convenience. But I – just wondering if you could just walk us through what you're seeing in terms of elasticity as those fresh categories maybe come down and what you're seeing in the volume responses as a result, as well as just the competition. Are you seeing any change in the competitive environment, as some of those fresh categories, that had been elevated, are really coming back down?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Well, those perishable areas, it's always real competitive. Everybody through the cycle has to move the product. So, I wouldn't say it's any different than it was before. And that is the bulk of the deflation that we're seeing is from perishable product. There's also some deflation that really isn't the food itself, but container loads particularly, when you get to imported product, the freight was so elevated for a while. We do a significant volume, particularly from Italy, of imported products. And the costs for shipping a container has gone from as high as $20,000 down to as low as $3,000. And when you spread that over the amount of cases, that appears as if it's deflation, but it's not product deflation. It's just the supply chain getting back under control.

But for the most part, when you get into further processed products, they fight very, very hard to get price increases through the system. And they're not going to lower pricing. They may take less of a price increase in their normal cycle and they may even skip a year. You know, we don't know what they're going to do, but certainly reducing prices is not something that is commonplace.

Kelly Bania
Analyst, BMO Capital Markets Corp. Q

Thank you.

Operator: Well, we'll take our next question from Brian Harbour with Morgan Stanley. Your line is open.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC Q

Yeah. Good morning. Thank you, guys.

I just wanted to come back to the point you made earlier on kind of labor productivity. And what do you think would prevent that from getting back to pre-COVID levels? And what additional work do you think there is still to be done on the productivity side?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co. A

I think it's just learning curve is the biggest – a warehouse job is just not extremely difficult, other than the physicality of it, but there's still a learning curve. And people climb the early stages of that learning curve very quickly, and – but they continue to get better at what they do and they continue to get more accurate. And I think we have more benefit to get from that.

And drivers, it was very short going into COVID, as far as being able to get drivers. There was quite a shortage. And it's probably, right now, similar to what it was pre-COVID, not as bad as it was during the pandemic. But those people also, they get better and better as drivers. And they learn the job and they just get quicker and they get more accurate.

We just have – got to have the patience to work people through that. And I think that we should be able to get back to the pre-COVID kind of productivity and that will mean a lot for us.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC Q

Okay. Thank you. And then, George, I think in the past, you've commented just on some of the different customer segments within independents. What's kind of – where are you doing the best right now? You're also big in pizza, of course. I think we'd just be curious to know what you're seeing in kind of the pizza segment, for example.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Pizza, we continue to do well. The segment itself is not doing as well as it did certainly during COVID. But we're continuing to run single-digit growth, pretty much mid-single-digit growth; not where we would like to be, but we're pleased when we get our market share information.

We're doing very well in Hispanic. We're doing better than we've done in the past in fine dining area. It's not a huge percentage of our business, but it's doing very well, particularly center-of-the-plate. We've always done well in the independent casual diner and we're doing very well there. And that would be the categories were where we're doing the best.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: We will take our next question from Mark Carden with UBS. Your line is open.

Mark Carden
Analyst, UBS Securities LLC

Q

Good morning. Thanks a lot for taking the questions. So, you guys have posted some pretty strong private label results in recent quarters. Are you guys seeing any changes in adoption as inflation comes down? Does it vary much by cuisine type or, at this stage, is your brand equity just strong enough that you're continuing to see similar improvements in penetration?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Well, we are continuing to see the percentage of our sales that are our brands grow. And it's I mean, it's consistent month-to-month. And we put a pretty big emphasis on that. But we put the biggest emphasis on making sure that we give the customer what they want. It's our center-of-the-plate that's done really well. And when you get to a large category for us, like pizza, that's by far our highest percentage. Our brand goes into that customer base. And we incent our people pretty well to sell our brand. I think that if the macro gets worse, it will probably help everyone in our business with their brand, because the foodservice distributor tends to have a better price value on their brand than a national brand. And we'll benefit from that. We're pleased with where we're at. If we continue to see the month-to-month higher percentages, that would be better yet, but we're real pleased where we're at.

Mark Carden
Analyst, UBS Securities LLC

Q

Makes sense. And then, you guys have put together some pretty strong numbers once again in the independent market segment. How are you thinking about the health of the independent restaurants industry-wide in that current macro backdrop? And related, how are you thinking about the resiliency of the segment if we enter into a longer recession?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Well, I'm going to speak more to what our customer base is. But our independent customers are doing so much better than our chain customers are. And I think that we've been able to push them up the quality ladder, as much as you can in this type of macro environment. And they move fast and they can make changes. And I feel real good about the independent restauranteur. And I think that there's some great chains out there, but a lot of people just – they want to go to something unique. They want a unique experience. They get some unique menu items. I just think it's resilient and I think it's going to continue to do very well.

Mark Carden
Analyst, UBS Securities LLC

Q

Great. Thanks so much. Good luck, guys.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Thanks.

Operator: We will take our next question from Andrew Wolf with C.L. King. Your line is open.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Thank you. Hey. Good morning, everybody. I wanted to ask about operating expense growth in the broadline business, which decelerated nicely, but it's still above case growth. And so, there are some things to unpack there. One, I assume it's a lot more expensive overall for the supply chain just to deliver to an independent. And beyond that, you know, since your mix is more to new independents, that adds another layer of [ph] expense. Could you give me a sense of – or as expensive (46:00), how satisfied you are where you are now? And when you talk about macro normalization, I assume it means the cost structure. How much more there is to come and what the timing of that is.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. I think there's two things there. I think that our productivity isn't where we need it to be and we're investing in people, so we have more. Our percentage increase in drivers and warehouse people exceed the increase in cases. And we're really pushing that productivity, and we're pushing down the amount of overtime that they have. And then we've invested heavily in this cycle in our sales force. We've slowed that down some, because we have a good bit of training to do, but we're still close to double-digit over last year in number of salespeople. And that's a big expense to carry when you're not growing at quite that rate.

So, I would say it's those two things. And we feel good about where our expense ratios are headed, though. Our productivity keeps getting better and we have a confidence level around the new salespeople and the productivity that we'll be able to get from them.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Okay. If I could, I'd like to follow-up on some of your sales commentary. You said for the quarter, there was some penetration, but the way I heard it was, obviously, Omicron helped a lot with that. But is there anything sustainable with – I think at like at the [ph] share conference, you were saying today's (47:36) growth at same restaurants was not that good, lackluster or worse. Is there anything either changing in the market that maybe is improving or more likely something you're doing with the sales management that, perhaps penetration might improve from here or is it – just kind of vary with how the – your independents are doing?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Well, I think a lot of it is just how our customers are doing. As I mentioned earlier, we have this consistency around increase in customers. We're not getting a lot of penetration into the customers as far as dollars. I mean, their purchases versus the previous year in cases, a better way to look at it. And what we are seeing, though, when we get to the end of the month and run a report, we're adding SKUs. Those SKUs aren't showing up as more line items on the average order, because the items that they may be – they typically ordered it once a week and now they're ordering it three times a month or whatever. If they were using 15 cases of French fries a week before, maybe now they're 13.

As we see more restaurants come back online, I've mentioned this several times, but these truly are single purpose buildings. And it is very, very rare that when a restaurant is vacant, that something comes into that space other than a restaurant. And I think that'll all come together and level out as well. And that will, once again, look like pre-COVID. And you won't have this number of new restaurants coming online. And I think that the good operators are going to start running growth over the previous year. As to where now, I mean, we see it in a big scale with our chain customers. They're just not running same-store sales growth. I mean, there's exceptions to that certainly. But for the most part, they're not. And I think the restaurant world [Technical Difficulty] (49:35) is a lot more like it did pre-COVID soon.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Okay. And finally, George, you spoke about a sales funnel coming into Convenience, I think you said with some national chains. Is that things that are coming – are either in the bid process or you're more something a little more solid where you're kind of in the last stages of writing contracts and stuff, like how good do you feel about getting some national customers in there?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. I think just the comment that we have a really good sales funnel and it's a long sales cycle and that's really about all we can say. And once again, that we feel good about where we're at.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Thank you.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Thanks, Andy.

Operator: We will take our next question from Jeff Bernstein with Barclays. Your line is open.

Q

Hi. Good morning. This is [indiscernible] (50:36) on for Jeff. Thanks for the question. You've spoken about chain business declines the past couple of quarters. Just wanted to understand if that's something you're consciously shedding some unfavorable accounts or is it a scenario where you see chains actually experiencing some decline. That would be perhaps contrary to what we've heard from restaurants that have reported the past couple of weeks. And then, I have a follow-up. Thanks.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. Well, as far as what restaurants are reporting, we have our stable mix of business. And in aggregate, they are running negative. And as far as shedding business, that's pretty rare for us to do. We've done some of that. Sometimes, we just feel like we need a certain fee to continue with the customer and, pretty much, we lose the business. It's just rare for us to fire a customer.

But we're in a position right now where our business is pretty stable. We don't sell many people that we didn't sell a year ago. And almost everybody we had a year ago, we have now. So, they're pretty good comparisons. And we would like to be more aggressive than we are now. Part of that was getting a handle on where our expenses are. And we've had some real good improvement there and probably nothing more to say. We, obviously, we're not going to count – comment on any customer particularly, but we have some good ones. And we have some that that are good accounts and they're good operators and they're just going through a difficult period right now.

Q

Got it. Makes sense. And then, if I can pivot to M&A. You deleveraged nicely over the past few quarters and it looks like you're comfortably in your leverage range, so seemingly have a lot of dry powder. Could you talk about the current environment and your opportunity of perhaps accelerating M&A when you're smaller peers are presumably more challenged in a slowing macro?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. I would think that this would be a real good time for us to do some M&A. I can't say that we have anything that's imminent. We're trying hard. I think it's also a time where it's difficult for somebody in private equity to do it, the way the debt markets are. And they've been a competitor. So it's probably less competitive, but you still need two willing parties. And we're working hard at it. And I don't have anything I can report that we have coming. But we do feel like that we're in a position where so much of our debt is fixed. And we have a good balance sheet. We're where we need to be and we just need to get willing parties, I guess that would be the way to put it.

Q

Very helpful. Thank you.

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

I think you covered everything, George.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah.

Q

Thanks.

Operator: [Operator Instructions] We'll take our next question from Lauren Silberman with Credit Suisse. Your line is open.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you very much and congrats on the quarter. I just, first is, you talked about new customer acquisition being consistent at that 6% to 7% rate. Is the wallet share penetration with these new customers consistent with what you see with historical cohorts, so to speak? And then, second to that is, are you – do you see the – how long, I guess, does it take for that new customer to mature to his, I guess, full wallet penetration, which I think you've said before is close to 30%, on average.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

Yeah. It's an interesting question, because it's different than it has been in the past. We've been running a report every week, where we look at new customers that we hadn't sold before and what their average order size is. It's not much different than our existing customers, which typically, in the past, there has been a maturity about it. You know, you tend to get a weaker position in the account to start and grow it from there. But right now, and it's an anomaly for us versus our past, but they're about the same, same sized customer.

And remember that 6% to 7% is a net number. So we also have, unfortunately, accounts that we lose, but the new ones we're bringing on, they're coming on as fairly mature looking accounts.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Very helpful. And then, just [ph] about (55:25) 3% case growth in the quarter benefited from outsized January. I know there's a lot of moving pieces between independents, chains and other parts of the business, but can you help us understand, just putting it all together, how you're thinking about total company case growth next quarter and just as we think ahead?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.

A

[ph] So much that – us that is around that word, mix (55:46). We – I mean, a 3% case growth quarter can be very, very good for us and it could be very bad for us, depending on how that affects the mix of business. But we're modeling in that basically 3% to 5%, Pat.

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah. That's right.

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.
A

And that's about what we're looking at right now. And we want to continue to get that case growth in the segments where we have heavier focus and heavier profitability.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC
Q

Very helpful. Thank you very much.

Operator: And we'll take our next question from Joshua Long with Stephens, Inc. Your line is now open.

Joshua C. Long
Analyst, Stephens, Inc.
Q

Great. Thank you for taking my questions. I was curious if we could dive into some of the digital technology tools that you have. You mentioned your Customer First platform is largely rolled out across Foodservice at 90%, and maybe 100% at Vistar. Just curious where you are in terms of being able to leverage that and now that it's largely rolled out. And then as we think about kind of down the road, is there an opportunity to also leverage that across the Convenience side as well?

Patrick Hatcher
Chief Financial Officer & Executive Vice President, Performance Food Group Co.
A

Yeah. Now, that's a great question and I appreciate it. One, as you mentioned, we talked about how it's rolled off, over 90% of Foodservice and 100% at Vistar. Where I do want to reiterate, we're very early in the process of onboarding customers. Foodservice is coming along nicely and Vistar is doing a very good job of onboarding these new customers. And, again, the feedback from the customers was very positive. So, we're really focused on providing them a great experience and allowing them to continue to work with their sales person even more closely as they use this digital tool to continue to buy more products.

On Convenience, absolutely. We just wanted to get this – we're doing this on a step process, so first is Vistar, then Foodservice, and then eventually we will target Convenience as well. And then, that really is when we can unlock some of these cross-selling opportunities across all three segments with our customers.

Joshua C. Long
Analyst, Stephens, Inc.
Q

Got it. That's very helpful. I appreciate that. And one follow-up for me. George, when you think back to your comments about how fill rates are getting back towards pre-pandemic levels, it's perhaps on lower breadth of SKUs. As that maybe gets back to, from a SKU perspective, back to where we were previous, is that a positive? Does it introduce incremental challenges from an operational perspective? Just how do you kind of interpret that or how would you – what context could you add there just in terms of what it means from an operational or business perspective to see that SKU count start to rise again?

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.
A

Well, we haven't had a significant change in Foodservice, so that is more towards Core-Mark and Vistar. And I think that all-in-all, I would consider it a positive as they bring back SKUs. But, obviously, if they were real slow-moving SKUs, we would probably look at that as maybe a slight negative.

Joshua C. Long
Analyst, Stephens, Inc.
Q

Got it. Thank...

George L. Holm
Chairman & Chief Executive Officer, Performance Food Group Co.
A

No. I just don't think that that's going to have a material change. We would rather see a supplier that's still struggling to get the supply chain right on the SKUs that they have today and then move from there into some additional SKUs. But we are still experiencing fill rate issues, particularly with the large CPG suppliers that we have.

Joshua C. Long
Analyst, Stephens, Inc.
Q

Understood. Thank you.

Operator: It appears we have no further questions on the line at this time. I will turn the program back over to Bill Marshall for any additional or closing remarks.

William S. Marshall
Vice President-Investor Relations, Performance Food Group Co.

Thank you for joining our call today. If you have any follow-up questions, please contact us at Investor Relations.

Operator: This does conclude today's program. Thank you for your participation. You may be disconnect at any time.