

# FINAL TRANSCRIPT

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## **NAFC - Q2 2009 Nash Finch Company Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Alec Covington**

*Nash Finch Company - President & CEO*

**Robert Dimond**

*Nash Finch Company - EVP, CFO & Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Simeon Gutman**

*Canaccord Adams - Analyst*

## PRESENTATION

**Operator**

Good morning, ladies and gentlemen. Welcome to the Nash Finch second quarter 2009 conference call. The Company has asked me to advise you that this call will include forward-looking statements which involve risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. Factors that could cause such differences are described in the Nash Finch press release and in the Company's filings with the SEC, including its Form 10-K for fiscal 2008. The Company also notes that the call may include references to certain non-GAAP financial measures, as the term is used in SEC Regulation G, such as consolidated EBITDA.

Reconciliations of non-GAAP financial measures to the most comparable GAAP financial measures are provided on the Investor Relations portion of the Company's website under the captions, "Presentations" and "Supplemental Financial Information" and in the schedules to the Company's earnings release, which can also be found in that same portion of the Company's website under the caption, "Press Releases." It is now my pleasure to turn the conference over to the Company's Chief Executive Officer, Mr. Alec Covington. Please go ahead, sir.

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**Alec Covington** - *Nash Finch Company - President & CEO*

Thank you, Melissa, and good morning, everyone. Joining me this morning is the Company's Chief Financial Officer, Bob Dimond. As we've done in the past, Bob is going to give an overview of the financial results of the second quarter; and when he's completed with that, I will be back to have a few more comments about the quarter and then an update on the strategic projects that we've been working on within the overall Company. So with that, Bob, go ahead.

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**Robert Dimond** - *Nash Finch Company - EVP, CFO & Treasurer*

Thank you, Alec, and hello, everyone. Our total sales for the 12 weeks second quarter 2009 were up 18.8% to 1.22 billion compared to prior year sales of 1.02 billion. Our second quarter sales include 165.9 million of sales associated with three new military distribution centers we acquired on January 31, 2009. Excluding the additional sales associated with the acquisition and the shift of the Easter holiday to the second quarter 2009 versus the first quarter of 2008 of 7.6 million, comparable sales increased 1.9% over last year. Our total sales for the first 24 weeks of 2009 were up 16.2% to 2.36 billion compared to prior year sales of 2.03 billion. Our year to date sales include 277.6 million of sales associated with the three new military distribution centers we acquired.

Excluding the additional sales associated with the acquisition, comparable sales increased 2.5% over last year. Net earnings for the second quarter of 2009 were 9.5 million or \$0.72 per diluted share, compared to net earnings of 9.4 million, also \$0.72 per diluted share, in 2008. Net earnings for the first 24 weeks of 2009 were 24 million or \$1.80 per diluted share compared to net earnings of 20 million or \$1.52 per diluted share in 2008. Net earnings for the quarter and year to date periods were affected



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by several significant items which are presented in the table on page two of the earnings release, which affected both net earnings and consolidated EBITDA. The significant items negatively impacted net earnings by 1.4 million in both the second quarter's of 2009 and 2008, or \$0.11 and \$0.10 per diluted share, respectively. After adjusting for these items, net earnings for the second quarter of 2009 would have been 10.9 million or \$0.83 per diluted share as compared to 10.8 million or \$0.82 per diluted share in 2008. Significant items benefited year to date 2009 earnings by 4.7 million or \$0.35 per diluted share, and .8 million or \$0.06 per diluted share in 2008.

The most material item affecting the 2009 period resulted from a \$6.7 million gain net of tax realized on the acquisition of the three distribution centers. After adjusting for these items, net earnings for year to date 2009 would have been 19.3 million or \$1.45 per diluted share as compared to 19.2 million or \$1.46 per diluted share in 2008. As you know, we provide a supplementary schedule at the end of our earnings release which details our quarterly EBITDA results in terms of consolidated EBITDA. Consolidated EBITDA for both the second quarters of 2009 and 2008 were 33.6 million, or 2.8% and 3.3% of sales, respectively. The second quarter 2009 EBITDA was negatively affected by significant items totaling 1.4 million resulting from transition costs associated with the acquired military distribution centers, pre-opening costs for a new AVANZA store and non-capitalizable conversion costs associated with a new Family Fresh Market. The prior year quarter's EBITDA was negatively affected by .4 million for tax consulting fees.

After excluding these items, EBITDA for the second quarter 2009 would have been 35 million, a 3.2% increase as compared to 34 million in 2008. Consolidated EBITDA for year to date 2009 was 62.9 million or 2.7% of sales compared to 64.2 million or 3.2% of sales in 2008. The year to date 2009 EBITDA was negatively affected by significant items totaling 2.6 million resulting from transition costs for the acquired military DCs and costs incurred for the new and converted retail stores. After excluding these items, EBITDA for year to date 2009 would have been 65.5 million, a 2% increase as compared to 64.2 million in 2008. Our second quarter 2009 gross margin was 8.1% of sales compared to 9.2% of sales during the same period last year. Likewise, our year to date 2009 gross margin was 8.2% of sales compared to 9.2% of sales during the same period last year.

The gross margin rate was negatively affected by .6% of sales due to a sales mix shift between our business segments, with a greater proportion of sales now being in our military segment which operates at the lower gross margin rate than our other business segments. In addition, high inflation in the prior year resulted in higher than normal 2008 gross margin performance, and declines in commodity prices in the current year have temporarily impacted our margin performance relative to the prior year. Our consolidated SG&A expenses as a percent of sales for second quarter 2009 were 5.6% of sales, a decrease compared to 6.4% of sales in the same period a year ago. Our SG&A benefited by .6% of sales in the second quarter 2009 due to the sales mix shift between our business segments due to the higher level of sales now in our military segment operating at a lower SG&A rate of sales than the other business segments.

Our consolidated SG&A expenses as a percent of sales for year to date 2009 were 5.8% of sales, a decrease compared to 6.2% of sales in the same period last year. The SG&A margin benefited by .5% of sales in year to date 2009 due to the sales mix shift between our business segments as compared to the prior year, and this was offset by the first quarter increase in year over year non-cash closed store lease costs of 3.1 million and non-cash stock comp expense of 1.7 million, which combined were .2% of sales. Now I'd like to point out a few items in each of our business segments. First, the following is a breakdown of sales for each segment for the second quarter. Sales for the food distribution segment were 619.8 million in the second quarter this year, up 3.3% compared to 600.1 million last year, and were impacted by the Easter holiday shift by approximately 6.3 million or 1.1%. Excluding the impact of the timing of the Easter holiday, food distribution sales increased 2.2% relative to the prior year period.

Our military segment sales continued to be strong in the second quarter 2009, with sales of 461 million, up 61.1% versus 286.1 million last year. After excluding the sales of 165.9 million attributable to the newly acquired distribution centers, military sales increased 3.2% relative to last year, due primarily to increased domestic sales. Our retail segment sales were 135.8 million from the second quarter 2009, down 1.4% as compared to 137.7 million last year. Same store sales decreased .8% and benefited by the holiday shift -- the Easter holiday shift of 1.3 million or .9%. Excluding the impact of Easter, same store sales decreased 1.7% compared to last year. The following is a breakdown of EBITDA by business segment for the second quarter. The food distribution segment EBITDA was 23.4 million, or 3.8% of sales in the second quarter 2009 as compared to 25 million or 4.2% of sales in 2008.



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As discussed previously, fiscal 2008 was a year that included unprecedented inflation due to price increases in our inventories, which temporarily benefited our margin rates.

Please note, however, that we narrowed the gap in the food distribution segment EBITDA greatly versus the prior year to within 1.6 million in the second quarter compared to 4.2 million, which was the gap experienced in the first quarter relative to a year ago. EBITDA in our military segment was 12.4 million or 2.7% of sales in the second quarter, an increase of 7.6 million versus -- or 7.6% versus 11.6 million, or 4% of sales last year, and included acquisition and integration costs of .8 million or .2% of sales. The military segment EBITDA margin rate as a percent of sales was negatively impacted compared to 2008 due to the three newly acquired distribution centers which operated at lower EBITDA margin than the rest of the military business. In our retail segment, EBITDA for the second quarter was 6.8 million or 5% of sales, down just slightly as compared to 7 million or 5.1% of sales in 2008, and the current year quarter was negatively affected by pre-opening and conversion costs of .6 million, representing .4% of sales.

Total debt at the end of the second quarter was 338.8 million, which was an increase of 86.7 million since the beginning of the year, primarily due to the acquisition of the three former GSC military distribution centers; and at the end of the quarter, we had 147.7 million of availability under our credit facility. Our leverage ratio of total debt to EBITDA was 2.38 times at the end of the second quarter, which increased from the 1.75 times at the beginning of the year as a result of the acquisition. We continue to maintain a strong balance sheet with plenty of liquidity. Substantial improvement on our key financials targets has been achieved to date since the targets were announced as part of the Company's strategic plan in November 2006. Notably, our organic revenue growth metric has greatly improved, having flipped from being negative in 2006 to 2007 to now being positive in 2008 and 2009. And in this year's second quarter, our organic revenue growth was 2.4%.

Our consolidated EBITDA margin has narrowed the gap towards our 4% target. The ratio of free cash flow to net assets, excluding strategic projects, exceeds our 10% target at 12%. And finally, our total debt leverage ratio is slightly below the bottom end of our target range at 2.38 times EBITDA. These metrics have benefited in part from initiatives associated with our strategic plan. The Company announced on July 24th that our Board of Directors had declared a regular cash dividend of \$0.18 per share to be paid on September 4th, 2009 which is our 332nd consecutive quarterly dividend paid. I'll now turn the call back to Alec.

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**Alec Covington** - *Nash Finch Company - President & CEO*

Okay. Well, thank you, Bob. I think from my side just a few comments on the quarter. I think the first thing I would say is that we continued to see growth despite a weak economy around us. I think that is always encouraging, because in these times growth comes -- it's very difficult. It comes with a lot of hard work, but the Company has been able to achieve growth, setting aside the impact of the acquisition, as Bob mentioned, but also setting aside the impact of the Easter holiday; because setting aside both of those impacts, we still grew at about 1.9% on the topline for the second quarter.

Again, we feel quite good about that. We are pleased with that, given the environment that we are operating in these days. We are also optimistic that we will continue to show modest growth in the third quarter excluding the impact of the GSC acquisition. So we see that trend continuing. I think it will continue to be difficult. I think we are in a difficult environment; but we believe that we can ink out some modest growth here in the third quarter, as we've done in the first and the second quarter as well. I think the bottom line results were pretty much exactly as we had described they might be at the end of the first quarter.

If you will recall at the end of the first quarter, we mentioned that we thought the second quarter would likely come in relatively flat; and our feeling at that time was that we would see the increased EBITDA generated from the acquisition of the three military distribution centers, but that that EBITDA would largely be offset because of higher IT costs that we would incur in the second quarter due to converting the systems in one of the facilities, but also because we had a couple of stores to open up. And as you really step back away from the quarter, that's really the way it came out. We had the impact -- positive impacts from the three distribution centers acquired from GSC, largely mitigated by the IT cost from a system conversion in Pensacola, Florida, and the opening of our two new stores. Now if you really analyze the numbers carefully, will you see that we actually did \$1

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million better than that, because if you look at the one-time items, there was about \$1 million in extra one-time items in this quarter versus a year ago. So if you look at it that way, we actually came in a little bit -- about \$1 million, or roughly 3.2% stronger in EBITDA than we did a year ago.

Now as we look at the third quarter, we are expecting to return to a year over year EBITDA improvement in the third quarter. If you look again at the way we've tracked, we have indicated that we would fall short in the first quarter; and indeed we did, because of the amount of inventory investments that we had in play in 2008 because of inflation that just simply aren't possible during 2009. We indicated that we would close the gap on that and actually flatten out in the second quarter, and that's what we've been able to do. And I believe now as we look at the third quarter, we expect to see some improvement. Now, this improvement will not be dramatic. It will be slight. But we believe that we will ink out a slight year over year improvement in EBITDA for the third quarter.

As Bob mentioned, we continue to focus on very conservative balance sheet management. We think that's appropriate in these times, and we also think it's very prudent to maintain the highest level and most improved level liquidity that we can. Therefore, you'll notice that capital expenditures were only 4.6 million -- or under 4.7 million -- in the second quarter, bringing our entire year to date capital spend to just under 6 million, at about 5.55. As a result of that, we are once again lowering our CapEx forecast for the year. We, at the end of the first quarter, indicated that we would pull that CapEx down to roughly 50 million for the year. We are now seeing that that number will likely come in somewhere between 25 and 30 million for the overall year -- not for any other reason than the fact that as we've delayed some of these capital projects, it simply takes longer for them to be started and we simply won't be able to get all the money spent during the year.

So we estimate that in 2009, that total capital number will grow from the 5.5 level it is today somewhere between 25 and 30 million by the end of this fiscal year. As Bob mentioned, during -- at the end of the first quarter we had indicated that we thought we would be able to bring our debt levels down in the second quarter, and we have been able to do that; as a matter of fact, our overall debt levels reduced in the second quarter to the tune of 11.8 million. So as we said earlier, we are currently below our debt level goals. We set a goal to keep our debt levels between 2.5 and 3 EBITDA. Currently we are standing at 2.38 times EBITDA. Now, we do have some seasonal influences that comes to play in the third quarter, so it will be our expectation that we will see our debt increase in the third quarter to the tune of as much as \$20 million.

And that's due to no other reason than the typical seasonal inventory build that we have going into the holiday period, as well as some additional capital projects that we will see come to be in the third quarter. We also have placed a very high priority from day one on producing superior cash flow returns, and that remains central to our goal. We produced a cash flow return of 9.8% in the second quarter as compared to a 10% goal that we had. Now if you set aside the strategic projects that we are spending to open stores in the various things that we are doing from a strategic project perspective, that number was actually 12%. So we are still producing excellent returns on cash flow, and we managed that side of our business very, very carefully.

Now when we would look at our food distribution segment, that group continues to build on a previous track record of solid growth that grew to the tune of 2.2% in the second quarter excluding Easter, fairly consistent with the first quarter. We believe that sales will remain positive in the third quarter, at perhaps a slightly lower rate as we cycle through some new customers that were gained in 2008. So we believe that the growth track record will continue, albeit at a little bit slowing rate in the third quarter just simply because of some of the cycling. The EBITDA results for the food distribution business, as I mentioned, were exactly on track with what we expected. We had indicated at the end of the second quarter that it would be our goal to reduce the gap from the first quarter to the second quarter; and we did that, of course, coming in with a variances of only 1.6 million to prior year, and that being measured against the prior year where we had enormous investments in and heavy investments in inventory due to the inflationary period we were experiencing in 2008, which obviously is not positive -- and not possible in 2009.

We also expect EBITDA results to improve again in the third quarter. As a matter of fact, it's our expectation that by the time we end the third quarter, we'll see food distribution in a segment basis about flat or maybe slightly better than prior year. So if you look at where we started in the first quarter, we were over \$4 million negatively compared to prior year. The second quarter we



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tightened that gap to 1.6; and now as we look at the third quarter, it would be our thoughts that we will be able to flatten that out or slightly improve it. But I would say that we would have our sites more solidly on seeing it simply flat to prior year, which would be an improvement from where we are operating in the first and second quarters. Now in our food distribution operation, Operation Fresh Start continues to get the proper level of focus. Our new center store program that we launched initially in our Lima, Ohio facility continues to attract a great deal of attention from consumers and potential consumers and customers alike.

We now have just under 5,000 items in our Lima facility, with everyday value allowances that are reflected year-round that allows our customers to become more competitively priced with their large box competitors in the marketplace much. That's helping us and helping them. We are currently expanding that everyday value pricing to other Great Lakes facilities. That's being rolled out currently in Cincinnati, Ohio, in Bridgeport, Michigan and in Westfield, Indiana. So we are not only in the full roll-out phase in Lima, but we are now expanding that program to our other Great Lakes facilities to help enable and give our other customers the tools they need to more effectively compete in today's marketplace. We also have launched a new brand. The brand that we've launched as a Company is called Nash Brothers Trading Company. It is a brand that we will market for organic, natural and premium lines of product. It is currently in its initial distribution phase, and we're excited by the results.

We don't really have a lot to talk about except for the fact that it has been launched and that we've had some initial positive reaction. As a matter of fact, I got a personal letter from a lady in Michigan who described the Nash Brothers Trading Company Peanut Butter, the organic peanut butter, as being the best that she's tried. So we'll take that, and so far it has been very positive. Again, we don't have much more to report on that than simply the fact that we have the line launched, and we will continue to expand the line here over the next several months and years. But we will place a lot of emphasis on expanding that brand throughout our distribution center network and beyond our distribution center network. We also have been very actively involved in the continuation of our upstream/downstream distribution operation which we opened just after the first of the year in Bell Fountain, Ohio.

Lima, Ohio was completely integrated into that upstream warehouse as of March the 13th. Our Westville, Indiana facility was completed as of April the 3rd. Our Bridgeport, Michigan facility was completed as of May the 22nd. And the last, which was Cincinnati, Ohio, was completed on June the 26th. Now our results so far have been very encouraged. First of all, we have seen an overall improvement in fill rates and service levels to our customers, both from the upstream facility as well as from the downstream facility. So that results, of course, in improved customer service, and that's part what we were trying to accomplish with this initiative.

The second, we have seen a reduction in total inventory level, which is what we would expect by aggregating all of our slower moving products into one warehouse, it was our view that we should be able to run that facility more efficiently, that we should be able to turn the inventory faster, that we should be able to buy products better; and those things have already become visible, even this early in the integration process. Now, we still have a lot of work to do with that facility. It's not complete yet. The next steps is that now that we have the inventory for the most part moved out of the downstream facilities, we have got to get in there and completely reset those facilities so that we can reduce the selection travel required; and as we do that, we should see productivity improve in the downstream facilities beyond where they are today. So our expectation would be that we would begin to see improved productivity now in the third quarter, now that we've gone through the difficult integration process now in the second quarter.

Turning to our corporate retail segment, our comparable store sales were actually stronger than we had anticipated. We achieved a negative 1.7% after adjusting for the impact of Easter. Our forecast, if you will recall from the end of the first quarter, was that we would be closer to a negative 3% comparable store sales, primarily because we were cycling some new stores that we had remodeled a year ago, principally in the AVANZA area as well as our new Hudson store that we were cycling through. We believe comparable store sales will be negative, perhaps to about a 2.5% range in the third quarter. That is being driven by primarily two things. One is the cycling of new stores that we opened last year, or actually remodeled last year; and the impact of new competition which we are experiencing in the Denver market. I would also say from a bottom line perspective, we outperformed our EBITDA expectations primarily due to stronger than anticipated same-store sales and actually good controls.



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We -- as you look at the second quarter, you see that we actually overcame with those good results about \$600,000 of preopening and start up costs that are actually in those numbers. So we anticipate that retail EBITDA in the third quarter will be slightly below prior year, primarily driven by the competitive activity that we see going on in the Denver market right now with new Hispanic retailers that have entered that market and opened some new stores, which is putting some temporary pressure on our operation of AVANZA there in the Denver market. We made good progress on Operation Fresh Start from a retail perspective as well. We held our grand opening for our newest AVANZA store in Aurora, Colorado which is obviously a suburb of Denver, on May the 5th. The customer feedback has been very positive, and the store appears to be off to a good start in spite of heavy competition in the marketplace.

The new Family Fresh Market located in New Richmond, Wisconsin, held its grand opening on June the 9th. The customer feedback has been extremely positive and the store is running well ahead of our volume expectations at this time. The store is up over 20% from prior year, and we've seen the same kind of enormous growth -- strong growth -- in all the perishable departments, consistent with the kind of gains that we saw when we opened the Hudson, Wisconsin stores. So this helps to reinforce that we are on the right track with the format and that the consumer reaction remains quite strong when we go in and put one of these units in. In the retail area, as far as next steps, we believe it continues to be important to develop additional AVANZA locations in the Denver market. Our stores are well-positioned in that market. We will be fine, and we will be very determined to hold our ground and withstand the competitive attacks during the third quarter as we've done in the second quarter.

The stores continues to do very well. We will continue our work on the launch of our new Buy-n-Save format to be launched at a yet undetermined date. And we expect both of the Family Fresh units -- the one in Hudson, Wisconsin as well as the one in New Richmond, to continue to produce very compelling sales results in the third quarter. Turning to our military business, our sales growth remains very strong. As Bob mentioned, we saw a year over year increase of 61%, obviously influenced by the acquisition of the three military distribution centers earlier this year. But setting that aside, we still saw a 3.2% organic growth when you exclude the impact of the three additional district centers. We expect year over year sales growth excluding the acquisition to actual will be somewhat stronger in the third quarter than it even was in the second quarter.

Now when we look at the bottom line, EBITDA grew in spite of extraordinary transaction and system conversion costs of \$800,000 incurred during the quarter. So with that, we saw -- even in spite of that conversion cost and transaction cost -- we still saw an overall \$800,000 improvement year over year, and we actually expect stronger EBITDA improvement in the third quarter as we get some of these costs behind us and move on to more of a steady state operation there. And now discussing a little bit on the integration and Operation Fresh Start as relates to military, we obviously have been in the middle of integrating the three acquisitions -- the three military distribution center that is we acquired at the end of January. As we mentioned last quarter, Junction City, Kansas, has been fully converted in the first quarter and all areas are functioning properly. We completed the conversion of Pensacola, Florida, to our MDV systems at the end of May. The conversion proved more challenging than we had anticipated.

The cost of the conversion was greater than we had planned. But as we have said today, all systems are fully functional at this time, and we are currently seeing the logical improvements that we would expect to see each week; and we expect that to continue obviously in the third quarter. Now looking at the existing MDV business, as you'll recall, we also had strategic initiatives in our existing MDV business that primarily centered around something that we refer to as the Perfect Order Index, and that is an initiative that focuses on all the most important aspects of performance as we serve the DeCA and the military families. That is on-time delivery performance, our fill rate performance, the amount of errors and mistakes in an order and the accuracy of our invoicing processes. All of those collectively have improved year over year from 87.63% last year to 90.55% this year. So our Perfect Order Index is improving at a nice pace, and we continue to place great emphasis on moving that initiative forward. And it clearly is having a positive impact on the way that we are viewed by our customers in that side of our business.

Now as we look further in our military business at what we obviously need to do in the near term, while we still have one of the three distribution sends that have to be converted to MDV systems -- so that's in San San Antonio, Texas. So we will be looking to develop that conversion plan and either have the system either partially or fully implemented in the third quarter; but we



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will begin that work and either get it done all in the third quarter, or perhaps between the third quarter and the first quarter of 2010. Under no circumstances will we be doing any system conversions at work during the fourth quarter of 2009, because that's the time that's need to focus on holiday shipments and take care of business during an already heavily stressed period. So we will do what we can in the third quarter, and we will either get it all done or we will get some of it done; and whatever we don't get done in the third quarter of 2009, we will focus on for the first quarter of 2010. We also, as we mentioned before, continue to work on expanding our network in our military business.

We had mentioned that we are working to develop and identify at least one additional facility here in the near term. We are hopeful that we will be able to get that facility put together. We are working with state and local organizations -- government agencies -- to make sure that we secure everything that we can from a state and local perspective to make the numbers work, as well as looking at various existing buildings and developers and ground ups to make sure that we get the best deal as we look forward. But we hope to be able to identify one additional facility before the end of this year that perhaps could be operational during 2010. That remains our goal. A lot of things are critical to our being able to achieve that goal, but that's where we stand at this time.

And then as we look out, we are focused on seeing continual productivity improvements in the three acquired facilities, at least in the two of the three where the MDV systems have been installed; because it is our believe that as we get those facilities onto our legacy MDV systems we can see productivity rates that are more similar to the historical rates that we would see in a typical MDV-type facility. So that's kind of a snapshot of where we've been and where we are headed here at Nash Finch. Again, we are pleased with the overall quarter. We are pleased with the fact that we are growing. We are pleased with the fact that the quarter came in as we had anticipated, and we look forward to a slight improvement year over year in EBITDA in the third quarter and continued organic growth in our overall Company here at Nash Finch.

So that's about the size of it. Now, Melissa, if I could ask for your help, I'll be happy to take questions from whoever may have some on the

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). And our first question comes from Simon Gutman from Canaccord Adams.

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### Simeon Gutman - Canaccord Adams - Analyst

It's Simeon Gutman from Canaccord Adams. Alec, a quick question on the comps. I think -- or the retail side. At the end of -- or at least in the commentary from the previous quarter, I thought they were holding the line a little bit. Was it the competitive openings that happened towards the tail end? Did something change during the quarter? Was there additional deflation? And then if you can just tie that together with maybe what you saw on the distribution side, was there a similar pattern throughout the quarter?

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### Alec Covington - Nash Finch Company - President & CEO

Yes. No, I think when you look at the first and the second quarters, setting aside the impact of Easter, the retail comps were very similar. I think we had slightly negative comps in the first quarter; and as I mentioned, setting aside the impact of Easter, we've had similar results of negative 1.7 in the second quarter. We actually had anticipated that number would get worse. We actually felt the number would be closer to 3%, because we were actually cycling through the opening of the AVANZA unit in Omaha a year ago, as well as the opening of our Hudson, Wisconsin store a year ago. So we really, for those reasons, had anticipated it

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would get a bit worse. So actually as we look at the second quarter, they were a bit better than we had expected, and relatively consistent quarter over quarter between the first and the second, once you equalize for the impact of Easter.

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**Simeon Gutman** - *Canaccord Adams - Analyst*

And then if you can, to the extent you can talk about just what the distribution customers saw -- and I'm really curious because I think the competitive environment probably intensified a little bit, and that's more on a national scale. I don't know how much your customers are exposed to that; but to the extent it did, are they -- would they be getting hurt disproportionately, or they saw a similar trajectory to what your retail business saw?

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**Alec Covington** - *Nash Finch Company - President & CEO*

Well, I think our food distribution growth is really representative of the health of our independent retailers that are underlying it. I think the growth in our food distribution business was also very consistent between the first and second quarters without a lot of noise in the numbers. So we have not seen any near term changes. I mean, if you were to ask our customers -- and I'm with them quite a bit -- they would have told you in the first quarter that life was difficult and they would have told you in the second quarter life was difficult. But I don't know that they would view it as being more difficult in the second quarter than the first quarter. It's just been a tough year; not just driven, by the way, because of competitive activity, but also because of the changes in commodity pricing. And if you look at specifically dairy, dairy is one of the most challenging commodities for our customers and I think probably the industry right now; because when you look at cheese, milk, butter, all those kind of things, it's causing overall dairy product to be deflated in double digits, at least in our network this year as compared to last year.

And when you look at the size that the dairy department is with fluid milk and cheese and butter, that's hard to overcome, even if you are having solid growth in the grocery area. So we look at it more from a category perspective; and what we are seeing is that in grocery, the grocery area, there's more growth there and a little bit more impact of inflation, tremendous deflation in dairy; and also because of ice cream, you have some of the same carry over impacts in frozen. So our customers are really having to overcome more impact of deflation. I think that probably has had more impact on overall top line, both for our stores, our food distribution business and our customers, than any particular increase in competitive activity quarter over quarter from the first to the second.

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**Simeon Gutman** - *Canaccord Adams - Analyst*

And then I guess tied into that, on the food distribution side, given your comments that sales, I think, should be up about the same amount -- maybe a little bit better, I forget the commentary -- but then tying in the EBITDA being about the same, it sounds like the margin should basically be back or in line on a year over year basis as we cycle out some of the heavier gains last year. The question is, what's on tap? Are you starting to see more forward buy opportunities, or is that sort of moderate, or return to slight inflation still too premature?

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**Alec Covington** - *Nash Finch Company - President & CEO*

I think as we look at the overall results, what we are going to see is a topline growth that's relatively consistent from the second quarter to the third quarter. It might be just a tad less; but it's just going to hang into that slight improvement that we've been seeing in food distribution year over year under the 2% level you've seen both in the first and the second. That, I think, will continue in the third. The EBITDA dollars we believe will come in probably about flat. Now if those two things happen, then would you have maybe just a very slight decrease in overall EBITDA margin; but it would be improved from where we've been in the first and the second quarter. So we would see an improvement in the overall result year over year by being flat in the food distribution side of the business.

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Now when we look at the overall broader trends in food distribution, there really isn't anything that has changed that much. I think we our -- we are not seeing any kind of inflation. We are not seeing any kind of opportunities that we didn't have in the first quarter. We are not seeing a return to any kind of opportunities that we saw a year ago. What we have done, when you study the numbers carefully, is you will see that we have reduced a lot of our cost, that our overhead is much less than it was. We've taken actions that we thought was appropriate to make sure that we kept pace with this whole thing, that we didn't let it get out from under us. We've continued to see improvements in the sales of our private label products, of course, which is helpful. But I think it's really been muscling it out more than seeing any kind of real changes in the real business.

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**Simeon Gutman** - *Canaccord Adams - Analyst*

All right, and then last one and then I will let someone else come in. Just on sort of the strategic landscape and how you think of niche and future top line growth, and then maybe reaching some of those margin goals; and it's mostly speculation, but there could be asset divestiture potential within the distribution world -- and it's purely speculation -- maybe in the specialty side, there is assets up for sale, maybe in the traditional core. Just organizationally, would Nash be able to change direction to some degree just from a capacity standpoint, from a focus standpoint, or does it compromise some of the focus and some of the goals that you have going on right now?

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**Alec Covington** - *Nash Finch Company - President & CEO*

Yes, I think one of the reasons why that we have been very careful to manage ourselves with a very conservative balance sheet and lots of liquidity is that we have believed all along that this economy, that this environment, could create some real opportunities as we move forward. And we saw some of that, obviously, with the opportunity to acquire the three distribution centers at prices that were less than book value and been able to make some -- what we believe will be some nice returns on that. We believe there potentially could be other things that would occur. So we are watching and listening carefully, and we would be very patient. I think our focus at the top of the list would be to continue to expand our military footprint, because that seems to be working very well. We do have our ear to the ground to look at any opportunities that would expand our distribution of products beyond our current portfolio.

So if we had an opportunity to increase produce -- or an you mentioned specialty and those kind of things -- we would clearly look at all those opportunities. And then along the lines of traditional food distribution, we would currently -- we clearly keep our eyes open and our ears open, and we would want to be sure that any opportunities along those lines created a really stellar return. I mean, we are looking for high return opportunities in the food distribution business if they made themselves available. So we are not interested in paying high multiples for those type of businesses, but we think over the course of time there might be some opportunities that would present themselves that would make sense for us, complement our strategic plan, and we think that we are positioned well from a balance sheet perspective to take advantage of those, if and when they arise. But we are not going to try to make them happen. We are just going to be very patient and listen carefully and see what happens here over the next several months.

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**Simeon Gutman** - *Canaccord Adams - Analyst*

And to that last point that you made, just with respect to the core food distribution, because it's just by its nature just a slower organic growing business, does that mean that there just has to be very concentrated DC overlap in order to get those returns? Is that really the only criteria these days, or there is there just still inefficiencies out there distribution center by distribution center?

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**Alec Covington** - *Nash Finch Company - President & CEO*

Yes, I think as we look at our own business, we see that there will continue to be opportunities to drive efficiencies. With upstream/downstream just now being completed in the Great Lakes, we still have the other half of our business, which is located in the Midwest, where we have the opportunity to go do the same thing and drive those efficiencies. So we think that in our current network, there clear is opportunities left for us, even though it takes awhile. You have to be very careful, of course, as you install these systems and processes, because it does require an enormous amount of change, both at our level of operating as well as on behalf of, in some cases, of our customers. So we have to proceed very carefully. But we think those opportunities will continue to be there, and we don't think that we have capitalized on them all. I think as we look around us, clearly as we would look at acquisition opportunities having the ability to drive out redundant cost in synergies, whether that's capacity or overhead, would be at the top of the list of the way we would view those things.

It just simply is my belief that those type of businesses have to be acquired at a relatively low multiple to really be able to to have a long-term pay out, just simply because the growth trajectory of those types of businesses are never going to be as great as some of the other faster growing categories.

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**Simeon Gutman** - *Canaccord Adams - Analyst*

All right. Thanks.

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**Alec Covington** - *Nash Finch Company - President & CEO*

All right. Melissa, are there other questions we could answer?

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**Operator**

(Operator Instructions). And it looks like we do have a follow-up question from Simeon Gutman.

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**Simeon Gutman** - *Canaccord Adams - Analyst*

Hey, guys, sorry, I just got back in -- apologize if there are people waiting. Just on the MDV side, can you just talk about the run rate and potential time frame in which the margins -- I don't know if they will very quickly resemble what you did last year. I also don't know the extent that MDV or military side benefited in the same way that food distribution did with inflation. But if you can just talk about the pace at which margins start to walk their way back up.

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**Alec Covington** - *Nash Finch Company - President & CEO*

Yes, I think the -- in terms of the benefits that military had from a high inflationary period, they do have some benefits. It's greatly muted from what we see on the food distribution side, just by the nature of the business. So we do see some pressure year over year in our military business that is similar to our food distribution business. It's just a great deal less of an impact there just because of the nature of the beast. But it is there. When you look at the improvements to be made in the overall EBITDA performance, I think it really has more to do with the pace at which we can put the actions forward in the newly acquired distribution centers, because as you will recall, they were operating at an EBITDA margin that was a fraction what have we were operating at at MDV. And even though we knew that we would never be able to equalize the two because of the distance that is traveled at the three facilities that we acquired, we knew that by taking successive steps over a 36-month period that we could make dramatic increases.

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And maybe it's really the difference between a 3% margin and a 4% margin; but it's -- clearly shouldn't be long-term the difference between a 4% EBITDA margin and a 1% EBITDA margin. So we believe that it would take us about three years to ring out those improvements to be able to accomplish that. We thought that the first year being 2009 would be all about getting the systems in place, the people, and identifying where we would put the next facility. The real dollars gets ringed out of the three acquired facilities as we expand our network with a couple of additional facilities that will help us dramatically reduce the miles traveled within that network. That will take us about two more years -- 2010, 2011 -- to get that fully put in place. So 2009, it's about systems and building the framework, so not so much there. 2010, we get one facility. 2011, we get the other facility. At the end of the 36 months, we will be producing in excess of a 15% or 13% IRR on the acquisition and we will be operating at roughly a 3 EBITDA rate as opposed to where we started.

**Simeon Gutman** - *Canaccord Adams - Analyst*

All right. Thank you.

**Alec Covington** - *Nash Finch Company - President & CEO*

All right. Melissa, is that about it?

**Operator**

That is correct. We have no further questions in the queue.

**Alec Covington** - *Nash Finch Company - President & CEO*

Okay. Well, listen, I appreciate the participation this morning, and we look forward to speaking to everybody again. Remember that our third quarter is a longer quarter for us, so it will be sometime in November before we are back to talk to the group, so just keep that in mind. Thank you very much.

**Operator**

That concludes today's conference call. Thank you for your participation.

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