

# FINAL TRANSCRIPT

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## **NAFC - Q2 2010 Nash Finch Company Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Alec Covington**

*Nash Finch - President, CEO*

**Bob Dimond**

*Nash Finch - EVP, CFO*

## CONFERENCE CALL PARTICIPANTS

**Bakley Smith**

*Jefferies & Company - Analyst*

**Ajay Jain**

*Hapoalim Securities - Analyst*

## PRESENTATION

**Operator**

Good morning ladies and gentlemen and welcome to the Nash Finch second quarter 2010 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 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 the Company's filings with the SEC, including the Form 10K for fiscal 2009.

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 Web site under the captions Presentations and Supplemental Financial Information and in the schedules to the Company's earnings release, which can also be found in the same portion of the Company 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.

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**Alec Covington** - *Nash Finch - President, CEO*

Thank you Jenny and good morning everyone. I am joined here today by Kathy Mahoney, our Executive Vice President and Corporate Counsel of the company; also joined by Ed Bruno, our President and Chief Operating Officer of MDV, our military division; Christopher Brown, Executive Vice President and President and Chief Operating Officer of our wholesale business; and Bob Dimond, Executive Vice President and Chief Financial Officer of the company.

As we've done in the past, I'm going to turn the meeting over to Bob Dimond, who's going to review the results initially and then I'll be back in a few moments to put a little bit more flavor on the quarter and what we might see for the rest of the year. Bob?

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**Bob Dimond** - *Nash Finch - EVP, CFO*

Thank you Alec and good morning everyone. Our total sales for the second quarter 2010 were \$1.15 billion compared to the prior-year sales of \$1.22 billion, a decline of 5.1%. Excluding the sales of \$16 million associated with the previously announced transition of a portion of a food distribution buying group to another supplier, comparable sales decreased 3.8% over last year.

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Our total sales for the first 24 weeks of 2010 were down 1% to \$2.33 billion compared to prior year sales of \$2.36 billion. Our year-to-date sales included \$59 million of non-comparable sales from January associated with the three new military distribution centers we acquired on January 31, 2009. Excluding the additional sales associated with the acquisition and after adjusting for sales of \$16 million attributable to the transition of a portion of the food distribution buying group, comparable year-to-date decreased 2.8% compared to last year.

Net earnings for the second quarter 2010 were \$10.7 million, or \$0.81 per diluted share, compared to net earnings of \$9.5 million, or \$0.72 per diluted share in 2009. Net earnings for the first 24 weeks of 2010 were \$18.7 million, or \$1.40 per diluted share, compared to net earnings of \$24 million, or \$1.80 per diluted share in 2009. Net earnings for the quarter and year-to-date period were affected by several significant items, causing the results to not be comparable. These are presented in the table on page two of the earnings release which affected both net earnings and consolidated EBITDA.

These significant items negatively impacted net earnings by \$0.9 million in the second quarter of 2010 and \$1.4 million in the second quarter of 2009, or \$0.07 and \$0.10 per diluted share respectively. After adjusting for these items, net earnings for the second quarter 2010 would have been \$11.6 million or \$0.88 per diluted share as compared to \$10.9 million or \$0.82 per diluted share in 2009.

Significant items significantly impacted year-to-date 2010 net earnings by \$1 million or \$0.08 per diluted share compared to a \$5.4 million benefit or \$0.41 per diluted share in 2009. 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 military distribution centers. After adjusting for these items, net earnings for year-to-date 2010 would have been \$19.7 million or \$1.48 per diluted share as compared to \$18.6 million or \$1.39 per diluted share in 2009.

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 the second quarter of 2010 was \$31.9 million or 2.8% of sales compared to \$33.6 million or 2.8% of sales for the second quarter of 2009. The second quarter 2010 EBITDA was negatively affected by significant items totaling \$1.5 million resulting from cost associated with the announced closing of a distribution center as well as integration cost associated with the acquired military distribution centers.

The prior year second quarter EBITDA was negatively affected by \$1.4 million resulting from transition cost associated with the acquired military distribution centers and preopening cost related to new and remodeled stores. After excluding these items, EBITDA for the second quarter 2010 would have been \$33.4 million as compared to \$35 million in 2009.

Consolidated EBITDA for the year-to-date 2010 was \$60.5 million or 2.6% of sales compared to \$62.9 million or 2.7% of sales in 2009. The year-to-date 2010 EBITDA was negatively affected by significant items totaling \$1.8 million resulting from distribution center closing cost and integration cost for the acquired military DCs. The 2009 year-to-date EBITDA was negatively affected by \$2.7 million related from transition cost associated with the acquired military distribution centers preopening cost for new and remodeled stores and tax consulting fees. After excluding these items, EBITDA for year-to-date 2010 would have been \$62.3 million as compared to \$65.6 million in 2009.

Our second quarter 2010 gross margin improved by 10 basis points to 8.2% of sales compared to 8.1% of sales during the same period last year. Our year-to-date 2010 gross margin was 8% of sales compared to 8.2% of sales in the same period last year. The year-to-date gross margin rate was negatively affected due to the sales mix shift in our first quarter between our business segments with the greater proportion of sales now being in our military segment which operates at a lower gross margin rate than the other business segments.

Our consolidated selling, general and administrative expenses as a percentage of sales for the second quarter 2010 improved by 20 basis points to 5.4% of sales compared to 5.6% of sales in the same period last year. Our consolidated SG&A expenses as a percent of sales for year-to-date 2010 were 5.5% of sales, a decrease in comparison to 5.8% of sales in the same period last year.

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The following is a breakdown of sales and EBITDA by each segment. The military segment sales in the second quarter decreased by 1.0% and were reflective of weaker domestic sales, partially offset by an increase in overseas sales. The military segment sales increased 7.3% in the year-to-date 2010, reflecting the impact of the acquisition of three military distribution centers on January 31, 2009. After adjusting for the non-comparable sales impact of these distribution centers of \$59.4 million, military sales increased 0.5% year-to-date.

The military segment EBITDA increased by 18.9% and 16.4% in the second quarter and year-to-date periods 2010 respectively, compared to the prior year. This primarily reflects that impact of the significant operating improvements made in the acquired distribution centers compared to last year. The military EBITDA as a percentage of sales was 2.9% in the second quarter and year-to-date 2010, respectively, as compared to 2.4% and 2.7% in the prior year.

The combined food distribution and retail segment sales decrease in the second quarter and year-to-date periods compared to the 2009 periods was 7.6% and 5.8% respectively. The decrease in sales was negatively impacted by the previously announced transition of a portion of a customer buying group to another supplier during the second quarter 2010. After adjusting to exclude this sales impact of \$16 million, sales declined 5.6% for the second quarter and 4.7% year-to-date, which is primarily the result of a decrease in comparable sales to existing customers and by inflation in certain product categories. Retail same store sales declined 4.3% as compared to the prior year quarter and 4.0% in the year-to-date comparison. In addition, we have closed four retail stores since the beginning of the second quarter 2009.

The food distribution and retail segment EBITDA decreased by \$3.8 million to \$18.6 million in the second quarter compared to the same period last year. The year-over-year decrease in EBITDA included \$1.2 million of Bridgeport Distribution Center closing cost and \$1.4 million of increased health insurance claim cost. The remainder of the difference was primarily due to reduced sales. Segment EBITDA as a percentage of sales was 2.7% and 2.4% in the second quarter and year-to-date 2010 respectively, as compared to 3.0% and 2.7% in the prior year.

Turning to the balance sheet; total debt at the end of the second quarter was \$294.1 million, which was a reduction of \$44.7 million compared to \$338.8 million at the end of the second quarter of 2009. At the end of the quarter was \$193.1 million of availability under our credit facility. Our leverage ratio of total debt to EBITDA was 2.14 times at the end of the second quarter 2010, which is an improvement from 2.38 times in the prior year. We continue to maintain a strong balance sheet with plenty of liquidity.

Improvements in our key financial targets have been achieved since the targets were announced as part of the Company's strategic plan in November 2006. In particular, consolidated EBITDA margin improved from 2.2% to 2.8% of sales and the debt leverage ratio has improved from 3.11 times to 2.14 times from fiscal 2006 to the second quarter of 2010. The ratio of free cash flow to net assets also increased from 8.7% in fiscal 2006 to 10% in the second quarter 2010. Finally, the organic revenue growth metric has been negatively impacted by the current state of the economy, but should improve when consumer confidence begins to recover.

As previously announced, our Board of Directors approved a share repurchase program, authorizing the Company to spend \$25 million to purchase shares of the Company's common stock. The program took effect on November 16, 2009, and will continue until the date of the aggregate purchases reach 25 million or December 31, 2010. During the second quarter, we repurchased a total of 182,800 shares for \$6.5 million, at an average price per share of \$35.65. Since the program's inception, we have repurchased a total of 472,000 shares, for \$16.3 million at an average price per share of \$34.57. Finally, the Company announced on July 21st that our Board of Directors had declared a regular cash dividend of \$0.18 per share, to be paid on September 3, 2010. This is our 336th consecutive quarterly dividend paid.

I will now turn the call back to Alec.



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**Alec Covington** - Nash Finch - President, CEO

All right. Thanks Bob. I think, as we talked about during the last meeting, we had anticipated that the second quarter would come in short of the same quarter last year in terms of EBITDA. We had indicated that that would likely be the case and that's exactly what has happened. I think one of the things that we have to keep in mind is that as we look year-over-year we did see a decline in EBITDA, but what is interesting is that we were able, even on lower sales, to maintain the EBITDA margin rate and I think that speaks to the accomplishment that Bob was referring to earlier; improvements in some of our business areas along with strong expense control.

Inside the quarter we did, as Bob mentioned, experience higher than anticipated healthcare cost as well as incurring \$1.2 million in cost associated with consolidating our Bridgeport, Michigan facility. That consolidation is largely behind us; we'll have some cost yet that will still fall into the third quarter but by the end of the third quarter we expect that to completely be behind us.

Given the environment, frankly we feel fortunate to post these results, even though we never let ourselves off the hook for not being able to improve our EBITDA, because obviously that's what we're here for. We're working hard to ensure that we've got the proper groundwork laid, the right projects to ensure that that happens in the future as the economy begins to restore itself.

As you can readily see by looking at our military segment, the EBITDA margin is really demonstrating the improvements that we had anticipated would show up on the acquired distribution centers that we purchase a year ago in Junction City, Kansas, Pensacola, Florida and San Antonio, Texas. That's happening because the team there has focused heavily on productivity improvements, the new systems are paying off that we've installed in those distribution centers and the team there is executing extremely well in driving higher productivity and efficiencies within those centers.

In addition we've demonstrated something once again that we've become known for and that's the ability to properly calibrate our expenses to keep pace with volume fluctuations and you can see that clearly in our financial statements. SG&A expenses dropped over 7% or just under \$5 million year-over-year, in spite of the work that we're doing to prepare the Columbus, GA facility to open later this year. That's a 20 basis point reduction. That's a strong accomplishment in an environment where sales are pretty hard to come by.

The investments that we've made in our military business, along with our relentless attention to overhead expense controls clearly helped to offset some of the industry-wide challenges that we're facing in the food industry. We do expect to see a similar quarter-over-quarter percentage decline in EBITDA once again during the third quarter of 2010, as it's our belief that the economic challenges are still with us and are likely to continue with us for some time to come.

As is obvious from looking at our financial statements and our numbers, you can see that revenue continued to be soft due to economic conditions and the corresponding thrifty shopping habits of consumers. That continued in the second quarter. That's been with us for a while and continues with us right now. We saw a 3.8% comparable sales decrease that's really setting aside the impact of unusual events such as the change in the customer in the Southeast, so when you set all the noise aside, it really was a 3.8% comparable sales decrease year-over-year for the quarter and that's quite similar to what we were seeing in the fourth quarter of last year.

It was a little bit better in the first quarter because I think there was a little bit more strength in consumer spending but in the second quarter it really dipped back to about the same levels we were seeing in the fourth quarter. So this is fairly consistent with the kinds of bumps and tumbles that we've seen throughout this economic downturn. We believe that revenue will continue to be under pressure in the third quarter for the same reasons. We simply have no visibility as to when this trend will reverse itself.

The previously announced transition of some customers in the Southeast; you'll remember we discussed two quarters ago that we anticipated a group of customers associated with a buying cooperative to transition to another supplier in the Southeast. That transition actually began in the second quarter. It will continue in the third quarter in terms of its effect and it will be with



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us for a few more quarters. The transition is completely behind us now; that all occurred in the second quarter, so we'll have a full quarter impact of that transition coming at us in the third quarter and you should know that that will affect our food distribution sales to the tune of about \$45 million before we factor in any other impacts of the economy and consumer spending.

We continue to focus on conservative balance sheet management and liquidity. Capital expenditures were \$6.1 million for the quarter compared to \$10 million that we had anticipated, and that's simply because of some of the construction that has been going on in our new Columbus, Georgia facility. We anticipate it would get done a little bit earlier. There were heavy rains in Georgia, so we were a little bit slow in being able to hang steel and get our freezer operation up and running, so some of the capital expenditures that we anticipated coming into the second quarter from that facility expansion, will actually come in the third quarter.

We have previously discussed in the past that we feel that the current depressed commercial real estate market really provides advantages to us if we do our job right, as we continue to try to expand our military distribution footprint. One of the core points of our overall strategy has always been to continue to not just look for acquisitions but to organically expand our military business by putting new facilities and expanding our footprint so that we can better reach customers in markets where we don't quite have the saturation that we would like to have. As such we have identified two specific markets whereby we will most likely acquire three facilities in the third quarter in order to provide for future expansion.

Now I say most likely; the only reason I'm really bringing this up is I don't want to surprise anybody by the end of the third quarter when you see that we've spent capital that you weren't expecting. So I want to go on record to say we anticipate that we'll spend this capital but it's not a done deal, so we have to keep that in mind.

In light of that, we expect third quarter capital to be \$41.5 million, consisting of the following items. We anticipate that we'll spend approximately \$10.2 million for the construction work that's currently underway in Columbus, Georgia. That's to get the rest of the freezer operation completed and get that facility ready to come online in the fourth quarter. We anticipate that we'll spend \$23.2 million to purchase three facilities in two different markets to help us expand and further penetrate and expand our military distribution footprint.

We anticipate that we will spend \$1 million as a down payment on the purchase of our Pensacola facility warehouse that we currently lease today. When we acquired the three distribution centers last year, one of those facilities was under a lease agreement. We negotiated a purchase price and a purchase option as part of that lease arrangement with the owner and it is economically advantageous to us to acquire that facility so it is our intention to do so. And this \$1 million is the first of a series of payments that we'll make in order to complete that transaction and then we'll finish that process up in 2011. And that leaves of the \$41.5 million about \$7.1 million for normal maintenance capital items, which is about typical of where we would spend in terms of just typical maintenance capital.

Now if all of this comes to be as we anticipate that it will, that will mean that we will actually spend for the full year about \$60 million in capital in comparison to the 35 to 40 that we had previously discussed a quarter ago. The breakdown on that, if you think about it and Bob can correct me if I get it wrong, because I tend to use broader numbers in the way that I think about this, but if you break down the \$60 million, 50% of that, or \$30 million is attributable to the three facilities that we will buy in the two markets that I'm referring to and subsequent improvements that we anticipate doing to those facilities and having done before year-end and also the \$1 million payment that we'll make to begin to acquire the Pensacola, Florida facility. So roughly \$30 million of it is attributable to expanding our footprint along with the \$1 million that we'll pay on the down payment for the Pensacola warehouse.

Another \$15 million of the \$60 million will be what we will have spent by year-end to purchase and expand our new Columbus, Georgia facility, which again will come online in the fourth quarter. So now we started with 30, we add 15, that's 45; that means that for the entire year, we will roughly have spent about \$15 million on what we would consider normal maintenance items which is a little bit lower perhaps in line a little bit with what we've done in the past. So all of that capital, the \$60 million, all



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but \$15 million of that has specific return on investment criteria that will certainly position this company well for additional EBITDA growth in the future.

As we indicated at the end of the first quarter, our debt levels did drop as we had anticipated by about \$16 million from the first to the second quarter and now we're back under that \$300 million mark as we had anticipated. Keep in mind that this occurred in spite of the fact that as Bob mentioned, we purchased almost 183,000 shares of stock during the quarter. This evidences the continued strong cash flow characteristics of our company that we've talked about so many times. Our debt level remains quite low at 2.14, down again from the first quarter where we were at 2.22 time of EBITDA ratio.

During the third quarter, primarily as a result of the facility acquisitions discussed earlier, we do expect that our debt level will naturally rise a little bit. We think it could rise because of seasonal inventories and other things, but mainly because of these acquisitions. It may come up to somewhere around \$339-\$340 million mark, still a very conservative debt structure, given our strong cash flow generation and also the liquidity and the headroom that we have with our financing instrument.

Our game plan for the rest of 2010 will be to continue what we do and what we have done for a long time and that is to produce industry leading cash flow returns on that asset by investing that free cash flow in several items. First of all, projects that fuel our EBITDA growth such as the expansion of our military footprint that I talked about earlier and efficiency initiatives in our food distribution centers, which has been underway now for quite some time and continues.

I think it's also fair to note that our investments in our military distribution footprint that I talked about earlier should be taken as a clear signal to the market of the extraordinary competence that we have in our business plan. We will continue to manage this company with careful debt management. That's become one of the other trademarks of the way that we run our business and we'll continue to look for opportunities to continue to pursue a share repurchase program and finish the \$25 million authorization that we have that will be in place until the end of 2010. And we always keep our eyes open and our ear to the ground for any excellent acquisition opportunities brought about by the current economic climate or for any other reason.

Producing superior cash flow returns remains the hallmark of what we do here. During the second quarter we delivered an impressive 10% free cash flow return on net assets in spite of a difficult operating environment. For the remainder of 2010, we will take these returns down slightly in order to take advantage of the growth opportunities that I previously talked about. We are more than willing to do this because it positions us very well to provide excellent returns on these new facilities once we get them opened and fully operational.

As you can see from our numbers, we've been hard at work in reducing our costs. Those cost reduction initiatives continue. We are on track to achieve our initiatives that we set out for ourselves in a timely fashion and they're clearly designed, as you can clearly see from the numbers we posted, to reduce our overhead costs in order to assure that costs are properly calibrated to our revenue during these extremely difficult economic times.

By year-end we believe that EBITDA results will be slightly behind 2009, partially driven by several factors; the expenses associated with consolidating our Bridgeport facility into Lima; an increase in healthcare cost in excess of what we had anticipated; and cost associated with the acquisition of these additional sites; as well as the ongoing startup cost associated with our new Columbus facility.

So we've made a conscious decision to be aggressive in this period of time, to move faster to expand our military network and not to be afraid to expand our business during these times, frankly. It is because of these economic times that we have the opportunity to purchase some of these assets at such compelling prices. We're willing to do that. We're willing to go ahead and spend the money in acquisition cost and startup cost which are going to come at us now a little bit more and a little bit faster than we had anticipated but it's all about positioning ourselves for additional future growth through the expansion of our military distribution footprint as we talked about earlier.



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So for that reason, where we had originally anticipated that we could come in a little bit above or flat or a little bit below, because we're taking these actions to move faster with some of our expansion plans, because of the opportunity in front of us, with those additional expenses it will likely make it very difficult, if not impossible to come in above prior EBITDA levels. We're going to try, we hope and we'll continue to work hard but more than likely when we look back at the full year we'll find that because of those additional items and the economy, are running slightly below prior year, but we will end this year very well positioned for growth in future years and to me, that's the more important point.

I do apologize for not being able to be specific regarding the facilities that we've indicated we may purchase in the third quarter. I would like to be. I just wanted to make sure that the market was aware of it in case we did spend the capital it wouldn't be a total surprise to you. I can't talk about those facilities specifically for two reasons; one is the asset purchase agreements are not fully completed, they have not yet been signed on both sides and there's some work to do yet to complete that. We anticipate that they will be, but again, we've all seen these things not work out as planned before, so we'll make sure we've got plenty of room to wiggle in the event that something goes wrong.

The second and perhaps even the more important is that our state and local incentives have not yet been fully committed. We don't have any reason to believe that we won't receive those state and local incentives, as a matter of fact, some of the localities have already indicated that they're in favor of what we're asking for, but it does require state money and local money in order to make the returns as compelling as we think they should be in order to invest properly. And to be very candid with you, if we don't get those state and local incentives and the tax abatement credits and the job credits that we've asked for, we simply won't go. It's really that simple.

In today's market we find that the state and local political environments are very favorable toward being able to help us create jobs and put these facilities in where we need them, so we're very optimistic, but we're also very clear that we don't go if we don't go if we don't get them. One of the things I would say on that point is I think that the State of Georgia and Columbus, Georgia particularly really represents a role model for helping companies such as ours create jobs in a difficult environment. The State of Georgia rallied around our job creation opportunity in Columbus.

Columbus will create jobs for all citizens in Columbus that would like to pursue them, but it's particularly well situated to help the families that we have a strong alignment with and that is military families and we hope that when we're all done in Columbus, Georgia that we've helped to put back to work some extended families of military soldiers and enlisted that are helping to protect our country every day. That's also fundamental to what we want to accomplish with our military network.

With that, that is all I know that we can talk about for this particular quarter and with Jenny's help maybe we could see if there's any questions that anyone would like to ask regarding anything we've discussed. Jenny?

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## QUESTIONS AND ANSWERS

### Operator

(Operator instructions) Our first question is from Bakley Smith with Jefferies.

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### Bakley Smith - Jefferies & Company - Analyst

I just wanted to dig a little deeper into the military. Congratulations, by the way, on some of the growth initiatives you guys have been speaking about. On military, it was a little below what I was expecting, so I wanted to get a better feel for what's going on there and maybe perhaps I was off? Do you feel like it's just general weakness in consumer spending or do you think that there's anything regional going on? Do you see any color that we could grab onto with military on the top line?



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**Alec Covington** - Nash Finch - President, CEO

Ed can jump in here if he feels that there's anything additional that needs to be said, because he's right here with us. But what we're seeing in our military business and you'll see this over time as you become more and more familiar with that business is that when you look back historically over the years that we've been involved in the military distribution business, the growth in that business and the performance in that business at a top line level has been fairly consistent.

If you look within certain quarters, you'll find that there's some lumps. There are some dips and there are some valleys throughout the year and it's brought about by somewhat our inability to out-guess where some of those shipments are going to come from. As an example, imagine the DeCA system as being a gigantic supermarket chain and that all would run the same promotion in every single commissary around the world and imagine what kind of impact that would have on product movement. So, if there's a mistiming of a promotion between quarters, between months, it can cause huge swags domestically.

We also see that the export side of the business. We ship product to commissaries over in Europe from our Norfolk facilities. When you're done with the year, that business always looks comparable year-over-year but for whatever reason, the way those shipments fall within the year seem to be a little bit more unpredictable than you might imagine.

So when we look at our overall military business the first quarter is, has it been impacted by the economy? Yes, absolutely. Consumers are trading down and shopping there in similar fashion as they are to supermarkets. It just hasn't been impacted by anywhere close to the magnitude that the general broader retail/wholesale food industry has been impacted. So yes, there is that impact.

The second is, in this particular quarter I would say the way I would explain it to you is that our export business probably came in a little bit stronger than we would have anticipated in the first quarter. Maybe that will come at the expense of what happens here in the third quarter, but the second quarter exporting business was a little bit stronger than we might have anticipated.

The domestic side, the actual commissaries in the U.S. was a little bit softer. That could have been the result of changes in promotions, changes in merchandising that have occurred year-over-year because that affects it a lot, and also as you mentioned and as I've mentioned, the impact of consumers trading down. The commissaries are not immune to the economy; they are just much more insulated from it than the broader retail food industry. You have the same deflation in food products so if we have deflation in dairy in the supermarket, you have the same inflation in the dairy products in the commissaries, so you're going to see those absolute influences and part of that is what is causing the sale to be a little bit more challenging historically.

But, you also have employee issues. You don't think about it, but you do. You have employment issues with the retirees and enlisted just like you do with civilian. There are many spouses of military people that have lost their jobs in some parts of the Southeast and other places. And also retirees that maybe had a secondary job but they don't have it today. So it's the same influence but it's just not nearly as dramatic.

I think it's a little bit the economy, Blakely but I think also it's a little bit timing that we'll see when we get to the end of the year that maybe this particular quarter might have been a little bit overstated in terms of its impact, because we normally don't see a negative 1% in our commissary business. That was a little bit of an extraordinary thing for us to see. So we think, yes, it's partially the economy, but we think it also has to do with perhaps some timing of promotions and things that may look a little different by the time that we end the entire year. Does that help you?

**Bakley Smith** - Jefferies & Company - Analyst

Yes, that does. Thank you for the color. I guess this dovetails; (inaudible) did a little better on the traditional distribution side so perhaps some of these economic factors are playing in different ways, but how do you feel about the strength of your customers?



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We've all heard about intensifying pressure on the competitive front in retail and I wonder how you feel about your customers and how they're weathering the storm here, if you have any insight there? And that will be my last question, so thank you.

**Alec Covington** - *Nash Finch - President, CEO*

It's a very good question. I think on the civilian side, the traditional food wholesale and retail side of our business, I think it's largely reflective of the broader industry. If you look at our comparable sales and you take out all the noise from business that moved here and there, it really looks very similar to the broader industry. If you look at our own corporate retail stores, they're operating at about the median of the overall industry. We're not the best and we're not the worst in terms of comparable sales. So I think it's about what we would have expected.

One of the reasons why you might have a little bit more volume in our numbers than what you had in your model is the fact that we anticipated having a larger impact in the second quarter from the transition of the Piggly Wiggly business in the Southeast than actually occurred. I thought that number was going to be closer to 22 million when I talked to you at the end of last quarter. I think it came in roughly around 16 or so, so it was a little bit lower. I think perhaps the business stayed a little longer. I think also there were maybe some transitional issues where they needed to buy product from us longer because perhaps the new supplier wasn't able to take care of them as well as they needed.

I think the other thing we're seeing is a little bit of a market share shift there that we didn't anticipate. There are some of those stores that operate in markets that are close to one another and one of the interesting things that we found during this transition is that yes, the stores that have left have left, but the stores that have stayed have actually - they're buying more from us, so something's happening there. So there's a bit of a market share shift, where the stores who remain seem to be gaining a little bit more of the market share. Maybe that's temporary because the guys who left are in transition and maybe that will change and reset itself over the course of time.

My guess is if there was an upside surprise to you in the distribution model, it may have come partially from that. Now, when we look at the broader group of independent retailers and regional chain business that we do in that side of our business, I would say that that business seems to be trending at about the same level it has been for now during the last year or so. It is a difficult operating environment. They're fighting the same factors we are; deflation. But I will say our independent retailers have proven pretty agile and nimble in doing the things necessary to survive. They're doing the same things we are. They're cutting their cost; they're managing their balance sheet.

If you've noticed, one of the things that I'm quite proud of, at least thus far during this recession and during this economic time, you really haven't seen our bad debt expense pop up at all. And that also I think is an indicator that the strength of our independent retailers and their ability to survive, hunker down and shed expenses and shutter underperforming stores when they need to seems to be quite strong. So I'm very optimistic that they'll continue to be able to perform like that.

But, having said that, it's a difficult environment but I think it feels pretty steady, pretty solid. I'm not worried one way or the other on the food distribution side. I just think we're going to continue to have to muscle out sales both at corporate level as well as with our independents here, until this thing settles down a little bit.

We laugh and say that if Walmart could ever get a positive comparable sales growth, we'd all get a break because that is - we do not find any gratitude when they report comparable sales that aren't good, because we know what's coming after that. That means you're going to come a little bit harder and stronger. So they're having to deal with all of that. They also get caught in the shrapnel between Walmart lowering 400 more prices or whatever they do and then Kroger reacting to it. Many times they're caught right in the middle of that.



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But when you really step back and look at it, I've really got to give them a AAA-plus because their performance, if you really step away, it mirrors the overall industry and there would have been an argument to have been made that maybe it should trail the industry but they've not. They've held right in there and they've taken the steps necessary to survive.

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**Operator**

Your next question is from Ajay Jain.

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**Ajay Jain - Hapoalim Securities - Analyst**

Just in terms of the outlook for the retail and distribution segments, I noticed, Alec that your retail comps were down sequentially. Would you be able to comment at all on your trends in the current quarter, both for retail and in distribution just from a top line perspective?

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**Alec Covington - Nash Finch - President, CEO**

I think the way that we're performing now, I think the way it really looks, Ajay is the comp and the overall performance there looks similar to what we saw back in the fourth quarter of last year and then it seemed to get a little bit better in the first quarter and now it seems to be more like it was in the fourth quarter. So it's a little bit of an ebb and flow with the economy. There doesn't seem to be any material changes in that side of our business.

We will say that going forward in the third quarter we expect the comps on our retail side to be negative at about 4.5; that's partially because we continue to cycle through some events, consolidations and things that we've done in the past. But there really hasn't been anything that has fundamentally changed that business to any big degree one way or the other. It just continues to muddle along with the overall industry and the overall economy. I don't sense any major shift either way on that front, Ajay.

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**Ajay Jain - Hapoalim Securities - Analyst**

Okay. Alec, you mentioned as far as your updated EBITDA outlook - I realize you're not necessarily looking for a flat outlook or to eek out any kind of EBITDA improvement but do you think you could manage the decline to within 5% or 10%; is there any frame of reference you can give?

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**Alec Covington - Nash Finch - President, CEO**

I definitely wouldn't see us getting over the numbers you're talking about. I really see it being rather modest. I think in the second quarter, and Bob correct me, but I think we're in that 4% to 4.5% decline range in the second quarter. Maybe it was a little less than that in the first quarter. So I think if you take that 4.5% to 5% and just kind of play it out for the rest of the year, that feels like a good place to be. I don't see it being directionally any worse than that, Ajay.

The only thing that we're going to have to keep an eye on as we go throughout the year really is the additional expenses that we'll have associated with the facilities that we are trying to acquire. Because when you do that, of course you have additional costs and you've got fees and all those kinds of things that gets into that number. We've tried to factor that in as best we can.

But we think if you just take our current trend in the second quarter and roll that out throughout the rest of the year, it comes in with a slight year-over-year decline and right now we feel pretty comfortable with that range.

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**Ajay Jain** - Hapoalim Securities - Analyst

Okay and then just one last question. As far as the summer rollback program over at Walmart, I know that there has been quite a bit of commentary on how that's going and so far the impact seems to be limited, I think at least to some high volume categories like soda, so based on the rollback activity during the June quarter and what you're seeing so far in Q3, do you think the impact is getting more noticeable or not necessarily?

**Alec Covington** - Nash Finch - President, CEO

Well, I think the thing that we have noticed is a couple of things that we would comment on. And we don't have any real insights into what Walmart is doing. But from afar, just looking at it from our side, what we notice from some of the price checks is that it looks like some go up and some go down and our customers will immediately call us when they lower 400 and then we have to remind them, okay yes, but we do a full price check all the time so please understand there's another 400 over here that actually went up. Because they have to make their math work as well. So I think there's a little bit of a balance there of what's going on with pricing when you really analyze the full wall-to-wall look at those rollbacks.

The second thing that's been a little interesting to us and our retailers have commented on and we saw as well, has been more of the promotional orientation of some of those rollbacks. You mentioned the sodas. The soda for us is quite interesting because we can't fathom what that must cost in terms of merchandising dollars to support those kinds of prices and promotions. Granted they're a big company; they command a lot of buying power, but still yet, those things are very expensive and soda pop can blow your gross margin out of the wall about as quick as anything I know of when you sell it near, at or below cost.

So I think the thing that is a little bit interesting for us is that the pricing appears to be a little bit more promotionally oriented, where my experience observing Walmart over the longer term has been they've tended to be more everyday low price oriented in nature. So that is the observation.

In terms of the impact that it's having; I can't see any evidence of any additional market share erosion that's occurring as a result of it, but clearly it creates a lot of noise in the marketplace anytime they do these things we get no less than 500-600 calls about it and what can you do and a lot of noise in the marketplace. But when you stand back and look at it, I can't see that it, at least in our world is causing us to look at our business differently or change a course of action as a result of it.

**Operator**

(Operator instructions) It appears that there are no further questions at this time.

**Alec Covington** - Nash Finch - President, CEO

All right, thank you very much and we look forward to talking to everyone at the end of the third quarter. Thank you.

**Operator**

That does conclude today's conference and we thank you for your participation.



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