FINAL TRANSCRIPT

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NAFC - Q1 2008 Nash Finch Company Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Nash Finch first quarter 2008 conference call. This 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 2007.

This 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 in the Investor Relations portion of the Company's website, under the caption 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'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.

Alec Covington - *Nash Finch - CEO*

Thank you, Sharlon, and good morning to everyone. Joining me this morning is Bob Dimond, the Company's Chief Financial Officer, and Kathy Mahoney, the Company's General Counsel.

As we've done in the past, Bob will step us through, from a financial perspective, the first quarter, and then when he's complete with that, I'll be back to give a little bit of an operational overview of the first quarter, an update on the strategic plan, and then we'll be prepared to answer questions from the audience. So Bob, why don't you go ahead?

Bob Dimond - *Nash Finch - CFO*

Thank you, Alec, and good morning, everyone. Total sales in the first quarter 2008 were $1.022 billion, compared to prior year sales of $1.032 billion or a decrease of 1%. The first quarter sales decline was primarily due to the previously announced transition of a large customer in the food distribution segment to another supplier.

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Excluding the sales decrease attributable to this customer of $36.2 million, total Company sales were positive 2.6 in the quarter. The first quarter benefited, however, from the shift of Easter to the first quarter in 2008 as compared to the second quarter in 2007. This caused a favorable sales variance in the first quarter of approximately $7.9 million, or 0.9% of sales.

After adjusting for both of these items, sales increased by 1.7% for the quarter. It was nice to see the significant improvement to a positive sales comparison relative to the trends last year, which had been negative up through the third quarter 2007.

Net earnings for the first quarter 2008 were $11.3 million, or $0.85 per diluted share. This compares to net income of $5.3 million, or $0.39 per diluted share, last year. Results for the first quarter 2008 were favorably affected by several significant items, totaling $2.9 million, or $0.21 per diluted share, as detailed in the table included on page two in the earnings release.

I'd like to remind you that we provide a supplementary schedule at the end of our earnings release, which details our quarterly EBITDA results in terms of consolidated EBITDA as defined in our bank credit facility. You'll recall that one of the key financial targets identified in our strategic plan is to drive improvements in our EBITDA margin.

With this in mind, EBITDA for the first quarter 2008 increased to $30.6 million, or 3% of sales, and were up 21.4% as compared to $25.2 million, or 2.4% of sales last year. I'd ask that you refer to the table on page two of the earnings release, which details the significant items that affected EBITDA and net income.

EBITDA for the first quarter 2008 included two offsetting significant items that netted to a credit of $400,000 in 2008, as compared to none in the first quarter of 2007. This resulted from a favorable adjustment to bad debt reserves due to collection of receivables and was largely offset by a lease buyout payment.

Pre-tax income for the first quarter 2008 included significant net credits totaling $3 million in 2008, as compared to none in the first quarter of 2007. And in addition to the items affecting EBITDA, pre-tax income was favorably impacted due to the lease buyout transaction, which allowed for a reduction of lease reserve liabilities.

Additionally, the Company filed various reports to settle potential tax liabilities and, as a result, was able to reverse previously reported income tax reserves in the amount of $1.1 million, which favorably affected the first quarter results.

In total, as a result of these significant net credits realized in the first quarter, net income was favorably affected by $2.9 million, or $0.21 per diluted share. And excluding these items, net income would have been $8.4 million, or $0.64 per diluted share.

I'd now like to drill down into each of our business segments. The following is a breakdown of sales for each of our three business segments for the first quarter. Sales in our Food Distribution segment were $594.2 million in the first quarter 2008, down 3.4% compared to $614.8 million last year.

Excluding the decline in sales of $36.2 million attributable to the customer who transitioned to another supplier, Food Distribution segment sales increased 2.7%. The first quarter benefited from the shift of Easter to the first quarter in 2008 as compared to the second quarter of 2007, causing a favorable sales variance in the first quarter of approximately $6.6 million, or 1.1%, to last year.

After adjusting for both of these items, sales increased by 1.6% for the quarter. We are pleased with the positive momentum that is building in our core Food Distribution segment.

The sales momentum in our Military segment continued to be strong in the first quarter 2008 with sales of $297.3 million, up 5.5% as compared to $281.8 million last year. Both our domestic and export sales improved in the first quarter relative to last year.

Our Retail segment sales were $130.4 million in the first quarter as compared to $135.7 million last year, which primarily reflects the closing of four stores since the first quarter of 2007. Retail same-store sales decreased 0.3% in the first quarter versus the

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prior year. Same-store sales were favorably impacted by the shift of Easter, which increased sales in the first quarter by $1.3 million, or 1.1%, to last year.

Now, regarding EBITDA, the following is a breakdown of EBITDA by business segment for the quarter. Our Food Distribution EBITDA was $25.3 million, or 4.3% of sales, in the first quarter 2008, an increase of 22.4% as compared to $20.6 million, or 3.4% of sales, in the first quarter of 2007.

As mentioned in the earnings release, our Food Distribution segment EBITDA benefited from a couple of items, which can't be counted on in future quarters. First, the quarter included a reduction on our customer bad debt reserves totaling $1.8 million as a result of collection of receivables on reserved accounts. In addition, inflation and inventories during the quarter temporarily inflated our gross margin performance. And consistent with the past quarters, the EBITDA margin in the Food Distribution segment also benefited due to more effective management of inventories and better control of expenses.

EBITDA in our Military segment was $11.2 million, or 3.8% of sales, in the first quarter this year, an increase of 13.6% as compared to $9.9 million, or 3.5% of sales, last year. The improvement of EBITDA was aided by the increase in sales, but also benefited by inflation in our inventories as well as from expense reductions. In our Retail segment, EBITDA for the first quarter 2008 was $6.6 million, or 5.1% of sales, and relatively flat to the $6.8 million, or 5% of sales, in the first quarter 2007.

In summary, after excluding the $400,000 of net favorable one-time significant items affecting EBITDA, total Company EBITDA increased by 20% to $30.2 million in the first quarter 2008, versus $25.2 million in the same period last year.

Next, let me comment regarding the progress towards our long term, key financial targets identified in our strategic plan. One of our key financial targets is to achieve an improvement in our total Company EBITDA margins of 4% of sales. Just as important, we've also targeted to achieve free cash flow returns on net assets of 10%, a 2% sales growth rate, and to deliver our balance sheet to a debt-to-EBITDA ratio of between 2.5 to 3 times.

Since announcing these targets in November 2006, we've realized significant improvements on several of these metrics. Our EBITDA margin has improved from 2.2% to 3% of sales, and our leverage ratio of total debt-to-EBITDA has improved, by a full turn of EBITDA, from 3.4 two times to 2.4 eight times.

Our ratio of free cash flow to net assets took a dip to 5.6% during the quarter, like we discussed that it would on the last call, due to having a higher level of inventory during the first quarter. Please note [we've a] new line item added to the financial targets table in the earnings release, which shows the ratio of free cash flow to net assets excluding the impact of strategic projects of 6%.

Finally, while our year-over-year sales have improved, we expect to make more significant improvements on the organic revenue growth metric as we implement initiatives associated with our strategic plan, in addition to making further progress on other metrics in 2008 and beyond.

Now, turning to the balance sheet, we ended the quarter with $148.1 million of borrowings on our senior credit facilities. Our leverage ratio of total debt-to-EBITDA was 2.48, relatively flat to the beginning of the year of 2.42, when the Company was in compliance with all financial covenants.

During the first quarter 2008, we repurchased approximately 358,000 shares of common stock for $11.9 million, at an average price per share of $33.61. After quarter end on April 11th, 2008, we entered into a new $300 million revolving credit facility, which replaced our then-existing term B and revolver, which would have matured in 2009. The facility is an asset-backed loan, which provides the Company with a reduced interest rate as well as with much greater flexibility. The facility also has an accordion feature, which allows us to increase the borrowings up to $450 million on the facility if needed.

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The Company announced on Tuesday that our Board of Directors have declared a regular cash dividend of $0.18 per share, to be paid on May 30th,, 2008, and this is our 327tth consecutive quarterly dividend to be paid.

I'll now turn the call back to Alec.

Alec Covington - *Nash Finch - CEO*

All right, thank you, Bob. I think as I look at the overall quarter, I would say something that I don't think I've said since I joined Nash Finch, and that is that, instead of saying that results were absolutely, precisely as expected, I would have to admit that the results were somewhat better than we had expected.

First of all, we didn't anticipate $0.85 a share. When you back out the one-time items, which obviously we all do, we're still at $0.64 a share compared to $0.39 a share a year ago. While we had envisioned some incremental improvements, we felt that the implementation of our strategic plan and a lot of start-up costs would mitigate a lot of those improvements as we went into this particular year.

What we didn't necessarily see coming as quickly as it came was the impact of inflation in our inventories, which has, as Bob mentioned, temporary -- and I would certainly make point of the fact that it is temporary, because when inflation would subside, we'll see our gross margins return back to more historical levels and trends. But for right now, we have an aberration in our gross margin line, driven by the inflation in inventory.

We signaled to the market back at the end of the fourth quarter that we would increase the amount of inventory that we had in the network due to this very issue. We do invest heavy in inventories when it's appropriate and when it is proper to get a payback. We do that for two reasons. One is to make sure that we protect our customers as best we can by making sure that we buy the product at the lowest possible price we can. And then in other areas, we do so in order to help complement and offset some of the expenses that we have in the business by having a higher gross margin.

So I think that that impact in the first quarter was certainly greater than we had anticipated, which is a major contributor in us overshooting what we had otherwise believed we would achieve in the first quarter.

Along with that, we had strong sales. As Bob mentioned, sales was positive, 1.7% when you set aside the impact of Martin's, which accounted for $36.2 million, and also the impact of -- the positive impact that was imbedded in our numbers from the shift of Easter from the second quarter last year to the first quarter this year. That sales number was a bit stronger than we might have otherwise thought -- again, driven by new customer growth, which we're excited about.

And also, we're seeing growth in our existing customer base. Obviously, some of that is inflationary, we recognize that, but we're still seeing some strong growth factors in our existing customers that we're very pleased with.

We're also very pleased that EBITDA, as Bob mentioned, improved by just under 20% when you set aside the impact of the $400,000 of net one-time charges or one-time gains in EBITDA. And as he mentioned, there were some logical reasons for some of those one-times. We do have a keen focus on bad debt management, making sure that we manage the risk of our business.

And when we would have the opportunity to pay $1.4 million to relieve us of not just the $2.6 million in lease liability that shows up on the income statement, but actually $4.6 million was the total, some of which was in capitalized leases. So we had the opportunity to reduce some -- not just contingent liabilities, but once you've reserved for them, then they pretty much become imminent liabilities. So we took the opportunity to do that, and that created a favorable situation for us on the income statement, along with properly managing our bad debt, which I think we have demonstrated a clear, consistent path since we've been working together.

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In addition, as I mentioned last quarter, we do have some very clever tax people. This is a company that I believe has a tax department that's second to none with the leadership of Paul Bischel and the whole group up there. So now, to be able to provide yet another tax reversal of $1.1 million, I think is evidence of the fact that they are on their game. And that's just a big a part of managing any business as any other aspect -- sometimes overlooked, sometimes undermanaged, but extremely important.

Now, we made a commitment as a Company and as a Board to make sure that we created shareholder value through our share repurchase program. We have executed against that. It wasn't just a press release and something that we said we might do. We said it, and we've done it by purchasing another 358,000 shares. That's a grand total of 770,000 shares that we've purchased through the end of the first quarter. And obviously, at the prices that we've been able to acquire those shares, we believe that it was certainly a good decision for our shareholders, and we feel very positive about that.

We did -- as we mentioned, at the end of the fourth quarter, we made a decision to take our debt levels up slightly, but when you look at our ratios, we're still sitting at 2.48. That's just up very slightly from 2.42 at the end of the fourth quarter, so it didn't have a lot of impact on our ratio, but we were still able to take our debt levels up in order to support both the investments that we wanted to make in inventories, but also the share repurchase program that we had previously announced.

So we feel very good about all of the key factors on an overall basis in our business. I think one of the things that's particularly encouraging about our business right now is that the most troubled part of our business a year ago is the part of our business that is showing some of the greatest gains this year, and that's our food distribution company. And that group is just doing a fantastic job in growing the business cleverly through new programs and working carefully with our existing customers to grow their business.

I see more and more evidence of where a customer that has three stores, we're helping him to find yet a fourth, and somebody that had five to find the sixth. And so we're assisting our customers to help them grow, which is very positive in their business and ours, but we're also able now to begin to attract new customers into our network, which has been evident now for the last couple of quarters.

And when you really look at the growth momentum in Food Distribution and set aside the negative impacts of having lost Martin's a year ago, but also the positive impact of Easter, the Food Distribution business actually grew in the first quarter at the rate of 1.6%. And yes, there is some inflation in those numbers, but it's still a very positive trend from where we've been in the past, and also an accelerated trend from where we were in the fourth quarter because that same number in the fourth quarter was 1.3, and now we've grown from 1.3 to 1.6 and will continue to work on that number going forward.

They also produced a significant improvement in EBITDA, a 22.5% improvement, when they weren't coming off of a year ago where we were actually showing a loss, they were coming off of a year ago where we were already improving, so this is significant. Now, when we carefully examine that 22.5% improvement, that is indeed where a lot of that food inflation shows up in its impact on our inventories. So it's my belief that a good portion of that overage is something that we have to understand is not sustainable over time. But yet when those opportunities present themselves, as a management team we'll always take advantage of those, both to benefit our customers as well as to benefit our bottom line.

The organization in Food Distribution, as I mentioned before, is also doing a good job in managing the risk. Their bad debt management continues to be managed very well in a business that historically has not always been able to produce good positive trends in bad debt management.

In the second quarter, this particular group will continue to focus on growth. We anticipate that in the second quarter, you'll see similar trends in top-line sales as we're seeing currently in the first quarter, once you set aside the impact of Martin's, which will contribute a variance of $34.3 million in the second quarter as compared to a year ago, and also from the shift of Easter.

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Now, Easter will hurt us more in the second quarter than it helped in the first quarter. The reason for that is two things. Number one, we have the week after Easter already in the second quarter, which is one of the worst weeks of the year for any retailer. And secondly, we have to understand that Easter a year ago was a first-of-the-month holiday, and therefore it really helped us a lot more in 2007 from that vantage point than it has helped us in 2008. So we'll be going up against those Easter numbers in 2007, which are pretty strong because it was a first-of-the-month holiday. And for a Company that has a lot of its business in rural areas, that's a significant change, when a holiday moves from the first of the month to the end of the month, as Easter did this year.

We do expect to see continued higher-than-normal inventories, which will continue in the second quarter to impact free cash flow over net assets and probably will maintain that ratio at about the same level. It may get a little bit better perhaps in the second quarter because of other factors, but we'll maintain about that same ratio because we'll continue to see, I believe, significant inflation factors in our inventories in the second quarter, so we'll continue to maintain that ratio.

We will also focus on the on-boarding process of new customers, which we're transitioning in in various divisions in order to make sure that their success remains our number one priority. The organization in Food Distribution has done an excellent job of that in the first quarter, in on-boarding properly and making sure that the transition from one supplier to us goes smoothly, and I'm confident that they'll be able to continue to do that in the second quarter.

The beauty about the type of growth that we're experiencing is that it's not so dramatic that it places a great deal of risk on our resources. It's very incremental growth, which is a lot easier to absorb, and our team is doing a good job with that. We do believe that there is still more room for cost reductions in Food Distribution, so we're continuing to focus there, not just on managing the day-to-day block-and-tackle kinds of issues, but also managing towards strategic objectives to help reduce that cost.

And I have to mention that fuel has always been an issue in Distribution, but fuel is becoming our number one challenge and the thing that we have to manage and take most seriously. Therefore, we are meeting weekly to observe the progress with initiatives to try to help manage fuel consumption because we're at a point here where, at least from our experience, we can't find a way to buy hedge, we can't find a way to buy a fuel contract to mitigate that cost. Diesel fuel has now topped the $4-a-gallon mark, which in my view is a critical point, and not just to us, but to business everywhere. So we're working very hard and aggressively to reduce our consumption in order to manage these costs,. So that'll be a major priority for us in the second quarter. Not that it hasn't been in the past, but it's become a number one item on my weekly staff list to understand what are the specific things necessary to accomplish that and how are we progressing against those so that we manage it very aggressively.

In Corporate Retail, as Bob mentioned, we had negative comps of negative 0.3. That is slightly worse than we had anticipated. We anticipated a stronger Easter holiday in the first quarter than we actually had. We failed to take into account the difference between an end-of-the-month holiday and a first-of-the-month holiday, so we didn't quite achieve what we had hoped to achieve in our retail costs.

In addition, we're seeing a continual shift from brand prescriptions to generic prescriptions in our pharmacy group, and that also is placing our comparable stores sales with some pressures that we haven't necessarily seen over the longer term.

And then lastly, it's clear from looking at our private label sales that the consumer is reacting differently, because we're seeing substantial gains in lots of categories where there have been tremendous price increases from the national brand side due to commodity growth. We're seeing more shifting in those specific commodities into more private label and store brands, and that, of course, works against our ability to have the comparable store sales that we'd like to have.

I will mention that our Avanza units provided notably strong comparable store sales at 7.93%, so we're very pleased with that group, and we expect to see continued strong results from that group as we move forward. And this group also, by the way, eked out an improvement in their EBITDA rate from 5% a year ago to 5.09% this year, which obviously didn't come without a great deal of work and good management on their side.

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In the first quarter, we'll continue to focus on aggressive perishables marketing in our conventional stores because that is -- that seems to be the trick for us in helping to drive our sales forward. I might mention that we hear a lot about commodity increases in grains, and that's absolutely true. The most -- the one that's being most highly publicized at the time of this call is rice, which is getting a lot of publicity. Rice, of course, has been going up over the last several months, and I expect will continue to go up over the next few months.

But one of the things that we fail to realize is that we are not in a period of time where we still don't have some deflationary items. If you look at beef and you look at the meat prices in the first quarter, we actually saw a decline in those prices, and with stores such as ours, that are heavily dependent upon perishable merchandising, those are impactful to us when we look at the price of beef and being depressed from the prices of a year ago. So it makes it a little bit more difficult, but yet the perishables side is where we can spend the most of our time and money and attention in driving sales for our stores because that seems to have -- prompts the most, the strongest consumer reaction.

In addition, I might mention that just, I guess, shortly after the close of the first quarter or right about the time of the close of the first quarter, we did complete the acquisition of the two Albertsons stores -- one in Rapid City, South Dakota; the other in Scottsbluff, Nebraska. Those stores have been completely converted now to the Family Thrift banner, and they are doing very well, and they're meeting -- and in some cases, exceeding -- the top-line expectations that we have.

I do welcome that group of employees to Nash Finch. We did bring on some very, very capable people that we added to our retail team with that acquisition, and we couldn't be more pleased with what we're seeing with that organization currently. And that, of course, will be included in our results at the end of the second quarter.

Now, our top line in the second quarter will be more dramatically impacted by Easter, so we expect to see a negative 3% comp or greater. It might be a little bit more than that primarily due to Easter. And of course, we still have to deal with competitive openings that we haven't yet cycled and the script changes that I talked about earlier.

When you set all of that aside, we believe that our negative comp sales, when you exclude Easter, is going to be comparable between the first and the second quarter; it's just simply that the Easter holiday will have an exaggerated impact in the second quarter as compared to the first.

In our Military business, we continue to be excited about this team. We never have to explain anything but good results for that group, in the sense that they had a 5.5% sales increase. That's primarily due to new customer additions and also increased sales within some of the existing commissaries.

Our domestic sales were particularly strong. We had apparently, it seems, more Navy ships in port during the first quarter, which helped. We also noted more traffic in the commissaries. I think that has somewhat to do with retirees and others stretching the dollar with the economy and the situation that exists today. That commissary becomes even a greater value when the economy is tough, so we're seeing some increased traffic there, which is driving sales a little bit higher.

Also, in our European ports and commissaries, we're seeing the weak dollar, which is helping to keep those sales on base in those European bases, which is helping to drive additional sales in our European bases, which is helping to fuel higher export sales from our MDV company, our military business.

EBITDA improved 13.6% for the first quarter. That is being driven by excellent inventory management practices and also just excellent expense control. As we move into the second quarter, we'll continue to focus from a Military perspective on organic growth -- that's what we do well. And a continued emphasis on operating cost reductions that this group has continued now recently to gain traction and continue to look and see ways that they can reduce costs and become more efficient.

I am very proud of Bob Dimond as our CFO and our finance team for being able to put in place this new ABL facility that we just put in place as a new credit facility. I think all of us on this call who are familiar with the credit markets understand that this is

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not the easiest time to have done that. And I think that by the combination of the great job that was done and the leadership by Bob and the finance team, but also the confidence that's been placed in us from our primary bank groups and Bank of America and all the syndicate partners, is indicative of their confidence in our strategic plan and what we're doing to improve this business, and also our ability to manage risk associated with this business. So we're very pleased with that, and my congratulations to all of them because I know first hand, as I know you do, that that was not a difficult task -- easy task in this particular credit market.

When we look at our strategic plan in Corporate Retail, we did open a new Avanza store, as we had indicated. That store is in Omaha, Nebraska. We actually had our Board meeting in Omaha, onsite at our distribution center there, and our employees hosted our Board at that facility and did a marvelous job. While we were there, we had the opportunity to show our Board of Directors the new Avanza store there in Omaha. That store has averaged a 30% sales increase over the last six weeks, and the average transaction size per customer has increased over $1, which is kind of phenomenal in this business.

Now, all of our Board was complimentary of the facility, but there's one particular Board member that made that particularly notable, and that's Sam Duncan, who is the CEO currently of OfficeMax. But previously he was the CEO of Fred Meyer and Ralph's and other notable food companies, and Sam remarked how exciting and how well done the merchandising plan and the product portfolio was in that particular store. Lots of excitement, lots of activity in the store, and we just couldn't be more pleased with what's happening with that particular unit.

Right behind that, we have under construction currently a second conversion from one of our corporate stores to Avanza in Greeley, Colorado. That store is pretty much tore up right now and is being completed and should be completed by the end of July. We also are bringing to a conclusion construction on one of our large everyday value formats that we will unveil in Wisconsin. That is going extremely well. The store is just going to be beautiful. We're really excited to showcase it for the marketplace, and we expect that to be completed by the end of June, so we'll have more to say about that at the next call.

And we have finalized plans and approved the capital for our first Buy n Save store -- that is our price impact, rural-based store. That'll be in one of our corporate stores that we currently own in Nebraska, and that work will begin immediately to convert one of our conventional stores over to the Buy n Save format, and we'll have more to say about that in the future as well.

In Food Distribution, we continue to move forward with our category reviews, which is having the impact of reducing the product costs that our retailers pay for goods and also allows them to reduce the retails that they charge for their product so that they get closer to large box retailers. I just can't -- I couldn't be more excited with the result. It is a painstaking task to bring together our customers and our vendors and our sales and get full agreement on what we need to do in order to accomplish that, but the results have been very impressive.

And beyond the wholesale results, which have demonstrated unit case increases out of our Lima division, which is our test site, we now have been able to tap into retail scan data. We operate a couple of corporate stores out of our Lima division, which is showing substantial -- not just unit increases, but sales increases in the categories that we've done so far. And also, one of our largest customers has been kind enough to share their [front-end]data with us, and we're seeing the same results in those seven categories evident in their company.

Our supply chain initiatives continue to move forward. Upstream facility is under way and under design for the Eastern part of the United States, as we had discussed with our strategic plan. And one of the important pieces of lowering the costs in operating costs but also in product costs has been the installation of a truly well designed, functional inbound freight system for our overall company. That has been installed here in Minneapolis using the LeanLogistics Transportation Management System.

We have put in place an entire department and leadership team downstairs to do that. They have grown our freight management program dramatically over the last year. When I came here, we were controlling a very small part of our freight. Now it's grown to almost double of where we started. And we have lots more to do, but that's important in lowering our expenses, but it's also important in lowering the product costs. So that is going extremely well, and that team is just really doing a fantastic job.

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Our Military division has been focused on what they refer to as the perfect order index. That's to take waste out of the system and lost sales that result from that waste. Julie [McManus], who has been put in charge of that initiative, has completed her black belt certification in SIGMA and has completely done a process review on our procurement. And as one would suspect, our service level and our fill rate has grown weekly, and now they're sitting at an all-time high in fill rate to our commissary bases, and so we're very proud of that.

And they're very deeply involved in recruiting additional bench strength that we need in order to continue to grow that business, and some of that's been done. There's more work to be done on that, but they're making good progress in that initiative as well.

In summary, we're very pleased with the results of the first quarter. We remain very committed to exactly where we started when we started together now almost two years ago, and that is we want a company that will generate 2% in organic growth or better. We want to generate 4% EBITDA to revenue. Is that easy? No, but haven't we made quite a few strides towards that end? I think so.

And we believe that we can maintain a 10% return on free cash flow. Sometimes, as right now, we'll make conscious decisions not to do that when we think it's in the best interest of shareholder return, because there is no single metric. There are times where you need to do something different in order to take advantage of an aberration or an opportunity. And of course, we remain committed to our EBITDA leverage rate of 3% or less.

Our key growth areas and our areas of focus is growing our Distribution business, as we have continued to do and will continue to keep the accelerator on that, solid execution of our strategic initiatives,. And I want to remind you that those strategic initiatives layer on each quarter, so we're going to see more impact in terms of capital spent and transition costs in the second quarter than we saw in the first quarter, simply because we have more activity now going on than we had before.

And it's our intention to continue to provide our targeted returns on our investments, whether that's purchase of shares that we buy, whether that is the investment of our capital internally in our strategic projects, or whether it is acquisitions, it's all about providing returns.

Keep the following in mind as you think about the second quarter. We do expect total Company sales to be negative to last year by about 2.25%. That is primarily due to the lost of Martin's and also the shift of Easter, so we have to overcome both of those in the second quarter. And then when we move into the third quarter, we should turn the Company totally positive in Food Distribution and also total Company. That has always been our plan. That's what we discussed with you at the end of the third quarter, and I think what we're seeing underlying in our Company says that that is indeed going to be the case, unless something that we don't see today occurs, and I don't know what that would be. So we'll not have to talk about this transition except one more quarter, and then we're done with it, thank God, and we can move on.

And we anticipate that there will be some year-over-year improvement in EBITDA, that's clear, but keep in mind that our transition costs associated with our strategic investments will be more evident in the second quarter than in the first quarter, and quite frankly, in the third quarter more than the second quarter. They just accelerate throughout the year. And the same with startup costs associated with our new stores.

However, our inflation in inventories will provide some limited relief on that that we didn't forecast. But I don't believe that what we're seeing today evident in the first quarter is indicative of what's sustainable either short term or long term. But to say that we won't see any in the second quarter, that's unrealistic. To say that we'll maintain the current rate I think is equally unrealistic. So let's be careful, because I'd hate to get off this call and look out there and see that everybody has become overly ambitious on what we believe we can achieve in the second, third and fourth quarter because of inflationary impacts in the first quarter that may not be that evident in the second, third and fourth.

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I'd love to be able to give you more precise thinking on that, but I can't. You just cannot forecast how you're going to be able to buy, what your mix of inventories will be at any one given time and how those inventories will translate into sales at any one given time as compared to the inflationary items that you've acquired.

Regarding free cash flow, it once again will be negatively impacted by intention, not just because of heavy inventories, but also because of strategic investments. As Bob mentioned, you do notice an additional line on the very back page, where we have added the free cash flow excluding strategic investments. We did that solely for one reason. We did it as a request from some of our largest shareholders who indicated to us that they understood that we had a need to invest capital in our business and that they appreciated and would support that, but that they'd still like to see the visibility of what our free cash flow returns are setting aside those strategic investments.

So it didn't have a lot of impact in the first quarter, as you can see -- very little. The biggest impact to free cash flow in the first quarter really was the investments we made in inventories, which are not something that will continue indefinitely. And when we would get those inventory levels back and get our -- not just our inventory levels, but also our accounts payable and other things that are connected to that back in more historical levels, then you see those traditional returns and [sorts of] returns on free cash flow that we've been able to deliver will pop right back up, and that, of course, is our intention.

With that, with the help of Sharlon, I'd certainly like to take whatever questions and clarify whatever I can for the group on the telephone.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) We'll have our first question from Karen Howland with Lehman Brothers.

Karen Howland - *Lehman Brothers - Analyst*

Good morning. Congrats on the good quarter.

Alec Covington - *Nash Finch - CEO*

Thank you.

Karen Howland - *Lehman Brothers - Analyst*

I was wondering if you could go through a little bit more detail on how the higher inflation is in fact benefiting your gross margin. Apparently in my mind, it seems that higher inflation would negatively be impacting your gross margin, especially if you're passing through all of the -- if you're trying to lower the prices for your customers as well.

Alec Covington - *Nash Finch - CEO*

Okay, that's a fair question. I think that when we ended up, I think, at the end of the fourth quarter, I signaled to the market that we would consciously take our inventory levels up and that that would negatively impact our free cash flow measurement. As a matter of fact, I think I forecasted a range right in line with where we ended up because I knew we would do this. And this is -- Karen, we're seeing inflation, and I hear a lot of numbers, and I can only tell you from an old guy who's been doing this for

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30-plus years, this is the most inflation that I personally have seen in our business since the 1970s. This is unprecedented in recent periods of time.

Now, in order to help our customers, we will take a forward position on as much product and inventories as we can, so if we know that the price is going to go up by X, we'll try to load our inventories prior to that level so that we can maintain that price to them. So when we do that, that in itself doesn't hurt our gross margin. What it does is it provides a low return on that part of the inventory because we're not turning it as fast, but it's worth it in order to help them hold that price. We also allow them to do that through programs that we set up with them that allow them to take, in some cases, some forward positions.

But there's another piece of it that is just systematically driven through our buying system that says, "Hey, on products that —" and they may not be the number one items in the supermarket; they might ancillary items. But when there's enough of them, it makes a real difference, and that is our computer systems, we've designed those in such a way that they will tell us when it makes good economic sense to invest capital in those same inventories for the purposes of enhancing our gross margin. So when we would take a forward buy position on inventory that is about to go up and then we would then maintain the price that the manufacturer suggests to our customers, then the difference between those two would be a gross margin gain for us.

And you're right, if we didn't try to help our customers, we would see an even bigger impact in gross margins, but that's not proper I don't think. And I think that what's difficult for me to describe to somebody like you who would like to have more insight into this, it's difficult for me to tell you what impact that's going to have because I never know exactly how much inventory do I have designated to try to help our customers that I'm not going to have a gain on and how much do I have that I will have a gain on and then how will the buy down of that product actually occur.

So it's a little bit by happenstance that you see these things, and I believe that that impact in the first quarter, let me say first of all, was much greater than we anticipated that it would be, and secondarily, I believe higher than it can be sustained, even in a high inflationary time. So we had a little bit of an aberration there.

I do expect that -- if you'll remember, I was very, very cautious on the growth year-over-year in EBITDA from 2007 to 2008 because I knew that we had to overcome all these transition costs and store opening costs and that we would have to improve our EBITDA just to cover those items, and I thought that, well, hey, what we'll do is we'll cover that and then we'll just eke out a little bit more and manage the implementation of our strategic projects to make sure that we do that.

What inflation has done is it's helped us to do a little bit better than that, and I don't think that it's fair to say from my chair that that's going to zero, that inflation is going to zero in the second quarter, but I also don't think it's fair for us to think that what we see in the first quarter is guaranteed to continue. I think there will be some element of that that will be with us for the remaining part of the year, but I think it'll be somewhat incremental and not necessarily dramatic from what we're seeing right now.

Karen Howland - *Lehman Brothers - Analyst*

Doesn't the fact that you are retaining some of the benefits of inflation kind of contradict the move towards kind of a cost-plus basis on this business?

Alec Covington - *Nash Finch - CEO*

Well, cost-plus -- no, it really doesn't, Karen. I mean, this has been the distribution business, golly, as long as I've been in it, and anybody who's in the distribution business that doesn't take an active role in managing and investing properly in inventories is probably not very experienced in distribution. I mean, it's just the nature of what you do. It doesn't have anything to do with our cost-plus, because the cost of the product that we sell is established not by us; it's established by the manufacturer.

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So we can -- if we poorly manage our inventories -- if you'll remember a year ago when I joined -- or two years ago, I'm sorry; I lose track of time. Two years ago, when I joined Nash Finch, we were actually seeing evidence of the reverse, where we bought products so poorly and managed our inventories so poorly that a promotion might come onto an item and we would have a high inventory level and actually take a loss on that inventory.

And so once you fix that, you stop the bleeding on poor inventory management, and then when you go to the next level, you sometimes have gains if you manage it properly. But it has nothing to do with our adjusting or feeling that we have some control over the cost of the product. We don't. That's the vendor, and we simply have to manage our inventories to either gain from that activity or lose from that activity or stand still.

Karen Howland - *Lehman Brothers - Analyst*

No, no, I understand that you guys don't have control over the costs. For some reason, I was under the impression that a couple quarters ago, you were speaking about a kind of evolving relationship with your retail customers that would move towards a cost-plus basis, and it was sort of a -- you all benefit when the customer ends up selling more of the product as compared to you all maintaining some of the vendor promotions and things along those lines, and so I was under the impression that most of your relationships were, or at least it was attempted to, move more towards a cost-plus basis and not managing around, I guess, inflationary times and things like that.

Alec Covington - *Nash Finch - CEO*

Yes, what you're talking about, though, actually has nothing to do with that. The cost of the product, once again, is established by the manufacturer regardless of what kind of sell program that you have. We have moved to that type of program as I mentioned, not totally throughout our company, but as we've mentioned several times, we have that in test in our Lima facility currently, and as I mentioned a little bit earlier, we are seeing substantial reductions.

But that has to do with changing the way that merchandising dollars are utilized. It has really nothing to do with the cost of the product. I mean, in our Lima facility, we have always bought products and marketed it in some fashion using the vendor's suggested list price for that bracket as an indicator, as component of that calculation, so that's nothing different.

The big difference is that when we would have more of the merchandising dollars applied to the everyday retail so that we can make sure that the retail price is more appropriately priced in comparison to large box retailers, that's what really drives that initiative, and we have done that. As a matter of fact, we've done it so much that our sales in our Lima facility within those categories is actually depressed. Even though we're selling more cases, our sales have actually gone down because the product cost reductions are so significant.

So the two things you're talking about are just not connected. They have nothing to do with one another. In our business, the vendor has always had a heavy influence on the way products are sold based upon their list price, and that doesn't change under any new selling program that we would have.

Karen Howland - *Lehman Brothers - Analyst*

Okay. Looking at Distribution, then, if you look at the 1%-plus of growth excluding Easter and excluding the impact of the loss of Martin's, how much of that is actually new customers versus customers buying additional product versus inflation? I was wondering if you could talk at all if you've actually lost any customers over the course of the quarter.

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Alec Covington - *Nash Finch - CEO*

Well, I mean, in any distribution business, you're always gaining and losing, so I mean, I don't -- I mean, the network is so large, I wouldn't even be able to list all those, nor would I. But what I can tell you is that we have consistently now for several quarters -- our gains in business have exceeded our losses on a continuing basis now for, I guess, three quarters, Bob, going back no. So we stopped the bleeding back some time ago in that regard.

Now, when we look at our growth, it is broken into new customer growth that we do -- we do know and isolate that number, so we do know how much is coming from new business. But a good part of it also is coming from existing customers buying more, and I don't know how much of that is inflationary and how much of that is just the fact that they're doing more business.

What I do know is that, in many occasions, it's coming because we have worked with a customer who owned three stores to buy yet a fourth store, and in some cases a fifth store to buy a sixth store. So it's coming more from those kinds of activities, but clearly inflation has got to be playing a role. But the only thing I caution with that is that our type of stores that we supply generally will have very high meat distributions, and we clearly didn't get a break from inflation in the first quarter when you look at beef categories and some of the other proteins inside the meat case.

And then when you look at the center store in a lot of our areas, yes, you had high inflation in a lot of commodities, except that you also had a lot of trading down into more private label and store brands. So it's always hard to see how all those things come together. There may be some that are smarter than I am and know exactly how to do it. I only know two things -- I know one thing is that we're gaining more business than we're losing from new customer growth, and I know that our existing customers are doing more business with us, and those are the only two things I really know.

Karen Howland - *Lehman Brothers - Analyst*

And so the volumes are actually up, though; it's not just inflation?

Alec Covington - *Nash Finch - CEO*

No, the actual volumes, case volumes, as well, is actually up.

Karen Howland - *Lehman Brothers - Analyst*

Okay, great. Thanks very much.

Alec Covington - *Nash Finch - CEO*

Thank you.

Operator

(OPERATOR INSTRUCTIONS) We'll go next to Ajay Jain, UBS.

Ajay Jain - *UBS - Analyst*

Hi, good morning. My first question I guess is for Bob, on your new credit facility. I guess compared to the term loan that you just replaced, it looks like this red over LIBOR has gone down a little bit. And I don't know how much you've drawn down on

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the new revolver, but can you comment at all on how much you expect in terms of the reduction in interest expense for this year?

Bob Dimond - *Nash Finch - CFO*

Sure. In comparison, in 2007 we were borrowing at LIBOR plus 250 on our old facility, and this new facility would be at LIBOR plus 200, so there's a 50-basis point improvement there, and at current borrowing levels, that would generate approximately $700,000 to $800,000 of reduction annually.

Ajay Jain - *UBS - Analyst*

Okay, great. Thank you, that was very helpful. And then on the tax rate, the 35% effective tax rate in Q1, it was a little lower than what we had expected, and I know that there were some tax credits that were cited in the quarter. But going forward, can you give any specificity in terms of what you think the representative tax rate should be through the end of the year, just for modeling purposes?

Bob Dimond - *Nash Finch - CFO*

Sure. We know that we ought to be, for the year, coming out to a weighted number of about 39.8%. So what that means is with this kind of one-time credit here in the first quarter, the next quarters ought to be somewhere close to the 40.5-to-41% range.

Ajay Jain - *UBS - Analyst*

Okay. And I guess just one last question. Maybe I'll address it to Alec. In your prepared comments, you confirmed that you're looking for very little EBITDA margin improvement this year, and I'm just wondering, to the degree that you've benefited just from forward buying recently and have had some other operational improvements in Q1, is the flattish EBITDA margin guidance simply -- does that imply that margin comparisons might be slightly negative in Q2 or in the back half of the year given that you had some temporary lift in gross margins in this latest quarter and you're also expecting to incur some more start-up costs for all these strategic initiatives as the year progresses?

Alec Covington - *Nash Finch - CEO*

No, what I would say is that we had originally indicated that in all the quarters, including two through four, that we would see just a very slight incremental improvement in the EBITDA rate, driven by year-over-year improvements and largely offset by start-up costs and transition costs. I have to back off that a little bit because I believe that the thing that I didn't know about then that I know about now is the impact that inflation would play in the course of this year. And so I have two cautions on that. One is I would ask that we don't assume that we could continue the same rate of inflationary factors in Q2 through 4 because I think that could be dangerous, but I think also for me to stick with the same statement that says there's not going to be anything but just a very, very slight comparable increase in EBITDA quarter-over-quarter with the type of improvement we saw in inventory management is also not accurate. So I think we're actually going to see our results in Q2 through 4 a little bit better than the guidance or -- "guidance" is not the right word because we don't give guidance, but the indications that we had given at the end of the third quarter and the fourth quarter.

Ajay Jain - *UBS - Analyst*

Okay, great. Thank you very much.

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Alec Covington - *Nash Finch - CEO*

Thank you. Any other questions?

Operator

At this time, it appears we have no further questions in the queue. I'll turn the conference back over to our speakers for additional or closing remarks.

Alec Covington - *Nash Finch - CEO*

All right. Well, listen, I appreciate everybody's participation today, and we look very forward to speaking to you again in July, after the end of our second quarter. Thank you very much.

Operator

That concludes today's conference. You may disconnect at this time. We do appreciate your participation.

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