FINAL TRANSCRIPT

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NAFC - Q2 2008 Nash Finch Company Earnings Conference Call

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PRESENTATION

Operator

Please stand by. We are about to begin. Good morning, ladies and gentlemen, and welcome to the Nash Finch second-quarter 2008 conference call. The Company has asked me to advise you that this call will include forward-looking statements which involve risk and uncertainties that could cause the 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, in the Company's filings with the SEC, including its 10K end fiscal 2007. The Company also notes that the call may include references to certain non-GAAP financial measures as the term is used in the 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 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's website under the caption press releases. It is now my pleasure to turn the conference over to the Company's Chief Executive Officer, Alec Covington. Please go ahead.

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

Thank you, and good morning everyone. Joining me today are Rob Dimond, the Company's Chief Financial Officer and Kathy Mahoney, the Company's General Counsel. As we have done in the past, I will turn the meeting over to Bob Dimond to go through a financial review, and I will be back a little bit later to talk about the quarter and a little bit of an update on our strategic actions.

Bob Dimond - *Nash Finch Company - Analyst*

Thank you, Alec, and hello, everyone. As an overall comment we are pleased with the results of our second quarter, which were on track with our expectations. As we communicated previously, the quarter results included some incremental conversion costs related to a couple of the major remodels that were well underway during the quarter, and also included some startup costs related to the two new stores that we acquired at the beginning of the quarter.

Our total sales in the second quarter 2008 were $1.042 billion compared to the prior year's sales of $1.064 billion. Year-to-date sales were $2.064 billion as compared to $2.096 billion last year. The declines in the second quarter and year-to-date sales comparisons were primarily due to the transition of a large customer to another supplier in mid-2007. Excluding the sales attributable to this customer of $34.3 million in the second quarter, total company sales were positive 1.2%.

The second quarter was also negatively affected by the shift of Easter to the first quarter in 2008, as compared to the second quarter in 2007 by approximately $8.7 million or 0.9%. After adjusting for both of these items, the second quarter 2008 sales increased by 2.1% as compared to the second quarter 2007. Likewise, excluding the year-to-date sales attributable to this customer of $70.5 million, total company sales were positive 1.9% compared to the year-to-date sales in 2007. Please note that we have just passed the one-year anniversary of the loss of this customer at the beginning of our third quarter and as such, beginning with our next quarter report we will have an apples-to-apples comparison going forward.

Net earnings for the second quarter 2008 were $10.1 million or $0.77 per diluted share. This compares to net earnings of $9.6 million or $0.70 per diluted share last year. Net earnings for year-to-date 2008 were $21.4 million or $1.62 per diluted share as compared to net earnings of $14.9 million or $1.10 per diluted share last year. Please note that net earnings for the second quarter and year-to-date periods of both years were favorably impacted slightly by several significant items detailed in the table included on the second page of 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. You will recall that one of the key financial targets identified by our new strategic plan is to drive improvements in our EBITDA margin. With this in mind EBITDA for the second quarter 2008 increased to $33.6 million or 3.2% of sales as compared to $33.3 million or 3.1% of sales for the prior year quarter. EBITDA for the year-to-date in 2008 was $64.2 million or 3.1% of sales compared to $58.5 million or 2.8% of sales in the year-to-date 2007 period.

We are pleased with the year-to-date increases realized in EBITDA which has benefited from improvements in both gross margin and SG&A expenses. I would ask you to refer to the table on page two in the earnings release which details several significant items; the effective net earnings and EBITDA, net earnings for the second quarter and year-to-date periods of 2008 included several significant items that sum to a net credit of $0.3 million and $3.2 million, respectively.

2008 EBITDA for the second quarter included items totaling a $0.4 million charge and the year-to-date period netted to zero. Net earnings for the 2007 comparable periods included significant items that sum to a net credit of $0.5 million for the second quarter and $0.6 million for the year-to-date period. Finally, EBITDA for the second quarter and year-to-date periods included one significant item for a credit of $0.7 million.

Our consolidated gross profit margin improved to 9.1% of sales for the second quarter 2008 as compared to 9% in the second quarter last year. Our gross margin actually increased by 0.4% of sales due to improvements achieved from better management of inventories and vendor relationships. However, these gains were partially offset during the second quarter by incremental noncash year-over-year LIFO charges of $1.6 million or 0.2% of sales due to the high level of inventory cost increases that have occurred. That accounts for approximately $0.07 per diluted share.

Our year-to-date gross margin was also 9.1% of sales compared to 8.9% of sales during the same period last year. The 2008 year-to-date period was negatively affected by incremental noncash LIFO charges, as well, of $1.9 million or 0.1% of sales, which represents a $0.09 per share impact.

Our consolidated SG&A expenses as a percent of sales for the second quarter 2008 were 6.2% and were flat to the 6.2% realized last year. SG&A expenses as a percent of sales for the year-to-date 2008 period were 6.1% as compared to 6.3% last year.

Now I would like to drill down into each of our business segments. Following this breakdown of sales for each segment for the quarter. Sales in our food distribution segment were $600.1 million in the second quarter this year, down 5.2% compared to $633.1 million last year. Excluding the decline in sales of $34.3 million relating to the customer who transitioned the food distribution segment sales increased by 0.2%. The second quarter was negatively affected by the shift of Easter to the first quarter in 2008 versus the second quarter in 2007 by approximately $6.4 million or 1.1%.

And after adjusting for both of these items the second quarter 2008 sales for food distribution increased by 1.3% over last year. Likewise excluding the year-to-date sales attributable to this customer of $70.5 million, food distribution sales were positive 1.4% compared to last year.

The sales momentum in our military segment continued to be strong in the second quarter with sales of $304.6 million in this year's quarter, up from 4.9% versus $290.5 million last year. Our retail segment sales were $137.7 million in the second quarter 2008 as compared to $140.5 million last year which primarily reflects the closure of four stores since the end of the second quarter 2007. Retail same-store sales decreased 3.9% in the second quarter 2008. But after excluding the unfavorable impact of the Easter shift of $2.3 million or 1.7% of sales in the quarter, same-store sales were down 2.2% for the second quarter, which matches the year-to-date same-store sales decline of [2 points] 2%, as well.

The following is a breakdown of EBITDA by business segment for the second quarter. Our food distribution segment EBITDA was $25 million or 4.2% of sales in the second quarter 2008, a 5.3% increase as compared to $23.7 million or 3.8% of sales in the second quarter 2007.

EBITDA in our military segment was $11.6 million or 3.8% of sales in the second quarter this year, an increase of 9% versus $10.6 million or 3.7% last year.

In our retail segment EBITDA for the second quarter 2008 was $7 million or 5.1% of sales compared to $8.9 million or 6.3% of sales in the second quarter last year. The decrease in retail EBITDA for the second quarter resulted primarily due to the conversion and startup costs associated with several strategic initiatives during the quarter.

In summary, our total company EBITDA margin as a percentage of sales in the second quarter 2008 of 3.2% was on track to our plan, which called for a very slight improvement in EBITDA margin rate over the prior year period which was 3.1% in the second quarter 2007.

I'd like to comment regarding our progress towards our long-term key financial targets identified in our strategic plan. As you will recall one of the key targets is to achieve an improvement in our total company EBITDA margin to 4% of sales. Just as important, we have also targeted to achieve free cash flow returns on net assets of 10%, a 2% sales growth rate and to delever our balance sheet to a debt to EBITDA ratio of 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% in 2006 to 3.2% of sales in the most recent quarter. And our leverage ratio of total debt to EBITDA has improved by a full turn of EBITDA from 3.42 times to 2.43 times. A ratio of free cash flow to net assets took a dip to 6% during the quarter like we had discussed that it would on our last call due to having a higher level of inventory during the quarter. Please note the new line item added in 2008 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 6.8%.

Finally, while our year-over-year sales have also 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 make in further progress on the other metrics in 2008 and beyond.

As previously announced, we completed the replacement of our senior credit facility in early April. The new facility is a $300 million asset-backed loan which provides the Company with a reduced interest rate, as well as with much greater flexibility. The new facility includes an accordion feature which allows the Company to increase the aggregate facility size up to $450 million if needed. At the end of the quarter we had $142.9 million of debt outstanding on our revolver and had $141.2 million of availability under that facility.

Our leverage ratio of total debt to EBITDA was 2.43 at the end of the second quarter, which is flat to the ratio of 2.42 at the beginning of the year. The Company was in compliance with all financial covenants at quarter end. The company announced on Monday that our Board of Directors had declared a regular cash dividend of $0.18 per share to be paid on September 5, 2008, and this is our 328th consecutive quarterly dividend paid.

I will now turn the call back to Alec.

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

All right. Thank you, Bob. I think the first comment I would make is that the quarter was really fairly uneventful and really the results were just almost directly in line with exactly what we had expected here as we planned our year back at the fall of last year. I think that one of the encouraging things of course, is that sales were positive once you set aside the impact of the loss of Martin's and the Easter holiday. A matter of fact, if you look at the quarter, the sales increase was actually above our longer-term target. So that was very encouraging.

Our EBITDA improved slightly, and that is what we had planned. I think you will recall at the end of the first quarter, as well as going all the way back to the third quarter of last year I indicated that as we began to reinvest back into our business, that we would see a lot more transition costs and startup costs. But we felt that even in light of that, that during 2008 we would be able to slightly improve our EBITDA rate and our EBITDA dollars and that is exactly what happened in the second quarter.

We were able to increase the EBITDA slightly in light of the fact that we had significant change in one-time charges from year-over-year. So when you look at the reversal and charges year-over-year, that was an additional $1.1 million worth of headwind that we had to overcome just to be able to increase the EBITDA. So when you look at it from that standpoint we are very well pleased with the result.

On a pretax basis there was a lot more noise in our numbers. I think it is important to understand what is in those numbers. If you look at the pretax income on our schedule you will see that earnings before income tax actually declined from $17.3 million to $14.9 million year-over-year. Inside those numbers are two very big influencing factors. One is the difference between the one-time charges from last year to this year. Last year we had the pickup from the reversal of some charges that had been taken back in 2004, which gave a positive impact a year ago.

This year, of course, we have the impact of some other charges that were taken during the quarter, and when you really flip them around, the difference in the charges on a pretax basis is $2.4 million. This year the bulk of the charges is related to the financing. We had to write off the deferred financing associated with our previous debt instrument. It was all non-cash, of course, but it does impact pretax earnings, that one item in fact it did by $1 million alone to the negative this year as opposed to the reversal of charges a year ago which helps us to the positive. So the swing between those two years on a pretax basis was $2.4 million.

In addition to that, as Bob mentioned, everybody and we are included, is experiencing a lot more inflation and higher cost in their inventories. Of course we book our inventories using the LIFO method. The difference in LIFO charge in this quarter alone year over year was $1.6 million, also impacting pretax. But again, no cash involved. Those two items, the LIFO charge, as well as the reversal from year-over-year and one-time charges, equates to $4 million in non-cash items that impacted our pretax earnings year-over-year. So when you look at the difference year over year of 2.3, and then you understand that there is $4 million in non-cash pretax items in those numbers, it helps to make a little bit more sense out of the quarter on a pretax basis.

As I look at the various business segments, I am really pleased with what has been occurring in food distribution. I am really particularly pleased with their growth momentum, which is now at 1.3% when you set aside the impact of Martin's and of course Easter. They did a show solid improvement in EBITDA. Food inflation had some impact on our margin for the quarter but not nearly to the extent that it did in the first quarter. And I think that you will recall that we indicated that that would likely be the case. That we would expect to see some inflationary impact on our inventories for the remainder of the year but we didn't feel that we would see that impact at the level that we saw it in the first quarter. So that all came in just as we had thought.

The food distribution group is making excellent progress in adding new customers and that to me is one of the most encouraging things that we've seen in that side of the business, and we are pretty excited about that. As we look at the third quarter the primary focus for the food distribution group will be to bring on board these new customers successfully. That will be their number one priority, to make sure that we get all the work done and get them safely into our business segment without causing them any disruption. And we do have a number of those initiatives underway right now.

I would say that we have -- we plan to open our upstream warehouse, which we've spoken about as part of our strategic plan late in the third quarter. There is a chance that we may delay that because of the new business activity that is occurring in our Lima, Ohio facility. Because again, I don't want that strategic project to influence our ability to bring these new customers onboard and get that job done right. So we will make that decision later but I think I had mentioned that we plan to open that warehouse at the end of the third quarter. That is still our plans but that could change according to how well we are able to get the job done of getting the stores tagged and bringing on the new business and how quickly we can get people hired. Because we are actually adding labor back into several warehouses around the country right now as a result of some of the new business that is being brought on board.

Year-over-year sales will turn positive of course in the third quarter. That goes without saying because we cycle through the Martin's business. But more importantly, we have growth that is occurring in that business segment. So we will see that more visible in the third quarter without having to always explain whether it is this or that in our numbers.

We do expect to see higher than normal inventories in the third quarter, and that will put pressure on our free cash flow to net asset ratio. So I think we could see that maintain at its current level going into the third quarter. And I think the other thing that is fairly obvious to everybody in any type of business today one of our big initiatives is to manage fuel consumption because it is a huge cost to us. But I would tell you as important as that is I worry a lot about the impact it has on our customers because that gets passed on in the form of fuel surcharges and there are fees that we charge, and that is okay but at some point in time it becomes a burden for them to be able to handle in their business, and that causes all of us to feel some pressure.

So we are trying our best to manage it; it is difficult for everybody, and there is not a thing in the world we can do about it. But it is something that we have to manage daily. On the corporate retail side of our business comparable store sales remain negative at about 3.9 for the quarter; of course that was influenced by Easter, and it is also influenced by an increase that we are seeing in generic prescription drugs. And when you do the math and swap from brand cost to generic cost, obviously that is a tremendous difference in the pharmacy units within our retail stores, as well. So those really are the big influencing factors for the quarter; and if you set aside Easter the stores would have still been negative but it would have been about 2.2% instead of 3.9%.

We had a strong Easter holiday last year that occurred in the second quarter, so it was -- that is difficult impact to overcome for that group. The AVANZA units I would say, that is our Hispanic format and as you know we have been expanding that format this year. If you single just those stores out, and of course there is not many of them, but if you look at just those units they actually had comparable store sales that was in excess of 13%, and that is in light of a new Wal-Mart opening in Denver near one of our AVANZA stores there in Denver. So we just couldn't be more pleased with the results that we are seeing in AVANZA and in the areas where we are investing in strategic capital.

Now speaking of strategic capital, that obviously had a negative impact on our EBITDA for the quarter, and we knew that would happen as we began to make investments back into some of our format in this side of the business. And if you look at where that pressure came from, about $1 million of it was associated with acquisitions that we made that we discussed earlier, and re-models that we did during the quarter. And if you think about it, I look at each one of those individually. The bad news is we acquired two stores in Rapid City and Scottsbluff. Anytime you acquire new stores you have an enormous amount of inventory change because the private label doesn't match, and you have to discount all those things that now you don't sell any longer and reset the stores, you have a huge amount of labor costs. So the bad news is all of that hit the P&L for us for those stores in the second quarter.

The good news is, is that today Nash Finch has the number one market share position in Rapid City, South Dakota, and that is something that we are very proud of. And unfortunately something that we can't say too many places around the country but we are very proud of that. And I will also say that the pre-existing stores that we had in Rapid City are also seeing substantial sales increases in that market as a result of the repositioning that we've done there.

So yes, we will take some pressure in this quarter to achieve those longer-term results. It just makes sense. So we are very pleased with that and unfortunately we knew we would have the cost in the quarter. Also we opened our first new format of a larger box type. It is our Family Fresh Market. It opened at Hudson, Wisconsin. The store is about 37,000 square feet. We incurred an enormous amount of cost in this quarter to get that done. That is the bad news. That is part of the $1 million I am talking about. This was a profitable store. We actually remodeled it while it was open, and it was a little like doing a complete construction job while at the store is open. And therefore, we incurred a lot more labor costs and a lot of cost associated with that transition and that, of course, is part of the $1 million that influenced our retail EBITDA numbers.

But the good news is that the store has been incredibly well received by consumers, and it is way ahead of where we expected the results to be at this point after opening. And it opened back in June and has been sustaining enormous sales increases since the beginning. So we are very pleased, and we will take that kind of result longer-term and we will suffer through the short-term consequences of that. It is understood. It is planned. We understand it, but it is a great investment when we look at where we have ended up there.

Third, we also had one of our other stores under construction to a point that customers couldn't really shop there to any big degree. That was in Greeley, Colorado. You will remember that I mentioned last quarter that we would convert that over to yet another, one of our AVANZA units. That work has been completed. However, during the quarter that store was constantly under construction. Our sales were actually down during that period of time, therefore EBITDA was impacted severely there during that period of time, and we understood that and we took that hit during the second quarter; but now what is the good news with that?

Well, the good news is it opened earlier this week, and it has averaged between 40% and 50% sales increase over the base that it had. So again, we've got another great success story with AVANZA. That is now two between Omaha and Greeley that we've done this year, and we hope to continue expanding that format with the kind of success that we are having.

In addition to that of course we had the impact a year ago having sold some scripts in a store that we had that added $0.5 million on a one-time basis a year ago that obviously we didn't have this year. But then we also invested money in market share growth in several markets in an attempt to improve our top line and our retail comps. And I think you will see in the third quarter that was a wise decision as we move forward. We are not investing in every market. We strategically look at the markets we are in and make decisions on which ones we think has the proper amount of opportunity for market expansion. We did that during the second quarter. We did it intentionally. It is proving to be a good decision for us, but it cost us several hundred thousand dollars, as well, in the second quarter.

So we had a lot of self-induced, self-inflicted movement in the second quarter that held back the results of our retail division but those are things that were planned, they were decisions we made and so far it looks like those decisions were good ones that will pay off big dividends for us in the future.

On the third quarter we are going to continue to be aggressive in the marketing of our conventional stores. We will continue to see some pressure in the third quarter, not to this level perhaps, but we will see some pressure in the third quarter. We expect the top line will now become at least flat, maybe slightly positive in the third quarter as a result of the remodels and the marketing efforts that we made. And we are going to, again we always are reviewing our stores to see if there are some that are non performing that needs to be looked at for closure or for disposition. We actually have already actually disposed and closed one location, that we closed I guess a few weeks ago if I recall. So that will be impacted in the third quarter. It is a store that was losing money and we were able to sell the script files and move on. And that is what we've done. You see a little influence of that in the quarter from some asset write-downs that shows up on our one-time list.

But we are always looking, and we don't mind investing in good stores, such as Hudson and others when we know we have an opportunity, and we are not shy to get out of markets and close stores when we see that it doesn't make any sense to continue on.

In our military segment, our military continues to be our best performing operations. It is as simple as that. We had nice sales increases once again, that they've continued to do quarter after quarter after quarter, and they had a very nice EBITDA improvement of 9%, which they continued to improve quarter after quarter after quarter. So it was an excellent quarter for them, great inventory management practices there, great expense control. They continue in the third quarter to push for organic growth, so I am sure they will continue that path. And they are really focused on their operating cost reduction initiatives.

Now as we go back and think about our strategic plan and operation Fresh Start, first of all as I mentioned earlier, we are making tremendous progress with AVANZA. We obviously launched Omaha earlier this year, Greeley has just opened, as I mentioned. Omaha continues to perform extremely well. The entire AVANZA group, of course, over 13% in comp store sales. All of that looks good. Denver showing good increases and all we are doing there is looking for additional locations to expand AVANZA as we can. And we will continue to do that carefully. We are not looking to do anything too dramatic. We're going to move slowly and carefully and make sure we take good, solid steps.

We have, again, we have had good response in Hudson with our large store Family Fresh Market format. We are looking to expand that in another location. I don't think we will get another one done before the end of this year, but we hope to have another one that will come online in the early part of 2009. In our food distribution group, they continue with their category reviews, as I mentioned last quarter. Every time they go through the category review process and make changes to the product portfolio and the pricing great things happen in terms of what the sales we see at retail level. That continues. The results are very impressive. And the good news about that is it is actually influencing some of our customers that are coming to us are coming to us because of that program, or at least influenced by it in one way or another. So that is adding new business in the Lima, Ohio where we have that test pilot going on. So we are really excited about that.

On a supply-chain side, as I mentioned, our upstream, downstream facility is slated to come online toward the end of the third quarter. We want to make sure we get all the transition there done prior to the holidays. If for some reason we are not able to do that because of the new business we are adding in Lima, we will delay it to after the first of the year. We definitely won't try to make that change during the holiday period. And our first priority of course is taking care of these new customers, and then secondly we will worry about the exact timing of when we open that new facility.

The military division continues to focus on their perfect order index initiative. They've made a tremendous amount of progress in procurement, and you already have seen those improvements in our fill rates and they continue their initiatives for recruiting for additional bench strength in preparation for the growth that we know will come and are confident will come in our military division.

In summary, I would say we were pleased with the results of the second quarter. It was right in line with where we thought it would be. We remain very committed to the target that Bob talked about earlier. When you look at the third quarter we've got our eye focused clearly on several things. First of all, the growth in our distribution business; making sure that we bring that business on properly. Continuing the improvement that we've made in expense controls and solid execution of our strategic initiatives and focusing on providing targeted returns on our investments whether it is through the share repurchase program, the strategic initiatives that we are investing in or strategic acquisitions.

I would keep a pay few things in mind for the third quarter. Obviously now that we cycle Martin's we do expect that our sales will become positive, of course in the third quarter companywide, as well as both in our military divisions and in our food distribution group. That is the first time that we've been able to say that for a long time in this company, so we look forward to being able to speak to that at the end of the third quarter.

We do anticipate some year-over-year improvements in EBITDA. As I mentioned before, but we have a lot of transition costs, startup costs that will flow through the P&L in the third quarter as it has during the second quarter. And the inflation that we are seeing in inventories will continue to provide some limited improvements that we didn't forecast, but nothing to the extent that we saw in the first quarter. And again our free cash flow measurement will be negatively impacted temporarily by some of the strategic investments that we are making, but also because of the inflation in our inventories.

A week or so ago I was looking at our inventory levels and our inventory level in cases was below prior year, but in dollars was substantially above prior year. So that is just a natural function of the inflation that is putting pressure on that aspect of our metrics, but that is something we will just have to work around.

In closing, we look forward to speaking to you again in November at the end of our third quarter. As we've done in past years it is our intent and our current plans will be to come to New York for this call and to subsequently meet with as many of our shareholders and analysts as would like to meet with us during the days following the earnings release to discuss our progress and plans for the Company just as we did a year ago. I find that very helpful to get insights from our shareholders, to get insights from our analysts. And so we will repeat that process again this year as our intentions are at this time. Now at this time I would like to ask the operator perhaps to help us take whatever questions we might have from those that might be on the phone.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Karen Howland, Lehman Brothers.

Karen Howland - *Lehman Brothers - Analyst*

Good morning. A question about the retail sales, and this is for Bob. I just want to make sure I am understanding this right. I noticed that the comp was down 3.9% but your total retail sales were down 2%. Are the new stores that you brought on this quarter just considerably higher volume than the ones that you had closed last year, or what is causing that discrepancy there?

Bob Dimond - *Nash Finch Company - Analyst*

Yes, I think there is -- they are slightly higher volume, the new ones that are coming in, so I think that would be a small piece of that there, as well as one of the things that you may have noticed is the adjustment between the year on the -- that we talked about in the first quarter versus the second quarter is the impact of the Easter week. Just two different sets of weeks compared together maybe accounted for 20 or 30 basis points adjustment, as well.

Karen Howland - *Lehman Brothers - Analyst*

So the comp is on a like for like time period whereas --

Bob Dimond - *Nash Finch Company - Analyst*

That is correct.

Karen Howland - *Lehman Brothers - Analyst*

Okay.

Bob Dimond - *Nash Finch Company - Analyst*

To get to the 2.2% we've essentially excluded the week that included Easter, and that it is comparable week in the associated or the other year.

Karen Howland - *Lehman Brothers - Analyst*

Okay, perfect. Thank you for that clarity. I was wondering if you could talk a little bit about at your retail locations and your customers, what you are seeing from the ultimate consumer. Obviously we've been hearing about people buying more on promotion and being more cost-conscious, looking for a value; I was wondering if you were seeing any trends in that?

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

Yes, I think we are seeing some of the same similar trends that we saw in the first quarter in that regard. I think that it is very clear that the consumers are struggling with the amount of inflation that they are seeing. The shopping mix has changed a little bit. Private label continues to increase disproportionately to the rest of our business. You are seeing people in certain cases shut down where they might have bought a steak, they are buying ground beef. You see some trends like that. Produce and fresh vegetables continues to grow at a fairly accelerated rate. So that might be a sign of maybe eating at home a little bit more. I don't know. But we are definitely seeing a change in mix and we are also seeing changes that vendors are taking to deal with their own sets of problems and issues and escalating costs.

As I mentioned a couple different times, not always does inflation translate into a sales increase. If you think about cereal manufacturers, they don't always raise the price; in many cases they make the box smaller, and we are seeing a lot of those tactics used to deal with the inflation. And that is inflation that doesn't translate into higher sales. So you are seeing all of those kinds of things occur. Now in certain parts of our markets we are also seeing a reduction in the number of shopping trips, but an increase in the amount purchased. I think that is particularly the case in some of the commissaries that we supply. So those are, I think, the bigger trends that we are seeing, Karen, unless you have something more specific you want to ask me about.

Karen Howland - *Lehman Brothers - Analyst*

No, that was -- that covers. Most appreciated. On the distribution side I know you had mentioned that you were going to be putting some additional customers through your centers. Can you talk at all about the volumes that that could be adding to your distribution centers?

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

These are not big chain type deals. These are 1, 2, 3-store groups. And I think right now we are in the middle of doing some of those conversions, so it's a little bit difficult for me right now because some of these stores are actually being tagged this week. We don't have a lot of visibility of the aggregate total. I think we will be better prepared to talk about that at the end of the third quarter after we've actually seen some of the results, but it is not going to make a huge difference in aggregate to our total business, Karen. It will help to drive our, obviously our comparable sales. It gives us a lot of confidence in looking at the third quarter and the fourth quarter that we will turn the corner and have positive sales year-over-year. But it is -- it does require a lot of work.

So if you are trying to bring on 15, 20 stores into a division like Lima, it is not easy, quite frankly to hire people. So that takes a good while and we want to do a good job, we want to be very careful with it. So it is more of the work that it creates perhaps more than the magnitude of the volume that it is going to add. And we will have a little bit more visibility of that in the third quarter for you.

Karen Howland - *Lehman Brothers - Analyst*

Thanks for that, and looking at the corporate expenses, does the $10 million per a 12-week quarter seem a reasonable run rate going forward?

Bob Dimond - *Nash Finch Company - Analyst*

Yes, I would say that that is generally a good run rate to expect going forward there. We do have a couple of items that may from a seasonal perspective shifted from one quarter to another, but actually on an annualized rate that is pretty close to where you have to expect.

Karen Howland - *Lehman Brothers - Analyst*

Great. Thank you very much.

Operator

(OPERATOR INSTRUCTIONS) Loran Braverman, Standard & Poor's.

Loran Braverman - *Standard & Poor's - Analyst*

I just wanted to inquire about the tax rate. I think it was sort of less, it was just a little less than in the first quarter but I think it was less than you had talked about on the last conference call, and I wonder what you think it will be for the year.

Bob Dimond - *Nash Finch Company - Analyst*

Well, let me explain that. In our significant one-time item table you will see that we did have kind of an extraordinary item in this quarter, and one which we didn't know exactly when it would occur. We did receive a tax refund related to an item that we had filed for a refund on towards the end of last year, and we actually received that in the quarter and were able to take that in to this particular quarter. So that did bring down our tax rate to about 32.7% or 32.4% for the quarter, but for the year we expect to be around the 37.6% effective tax.

Loran Braverman - *Standard & Poor's - Analyst*

Okay, so that would be 41% in the back half, then, approximately?

Bob Dimond - *Nash Finch Company - Analyst*

That's correct, no change from what we had said on a go forward basis.

Loran Braverman - *Standard & Poor's - Analyst*

Okay, great. Thank you.

Operator

Keith Curtis, Brant Point Capital.

Keith Curtis - *Brant Point Capital - Analyst*

Just wanted more clarification on these conversion costs and strategic investments. Could you -- I mean you clarified $1 million, I think, in conversion costs this quarter. Or is that the all in number? If we could just get our hands around what the kind of some of these one-time costs are costing you either this quarter or this year?

Bob Dimond - *Nash Finch Company - Analyst*

It is not uncommon when you are onboarding either a new store or remodeling, doing a significant remodel to have some conversion or one-time costs as that is happening, as that occurs, to the tune of $200,000 or $300,000 per store. I think that is pretty common and an average within the industry and that adds up to that $1 million that we hadn't spoken about.

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

Yes, and specifically it really, there is a whole bucket of things included in that, but I will give you just a few examples. First of all, when we acquired the two stores we actually closed the stores down for several days, and did nothing but do work inside, outside, paint, you name it. So we had an army of people in there from other corporate stores to help. So there is a lot of labor in that number. There is inventory markdowns in that number, so again, when you buy somebody else's store they have their brand of private label, you have yours, so you have to -- you would like to not buy it but oftentimes you are required to and you wind up taking a markdown to get rid of it and other items that just doesn't sell.

So it is those kinds of activities. And then when you think about Hudson and Greeley, we actually kept those stores open while they were being remodeled. And there is just no way you can have the same level of productivity and efficiency when you've got construction teams all over the store and you've got people constantly cleaning up and trying to keep the path open to make sure it is safe. And all of those items. So it is a combination of labor and gross margin that is really impacted by the acquisitions, as well as the remodels.

Keith Curtis - *Brant Point Capital - Analyst*

Right, and can you say what those store remodels may have cost you on the comp line this quarter?

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

You know, that is a good question, and I am struggling to -- I know that all of them were down on a -- so it would be a fairly significant number, but maybe we should get an accurate number on that.

Bob Dimond - *Nash Finch Company - Analyst*

I don't have that number for you here for the call but we can calculate that.

Keith Curtis - *Brant Point Capital - Analyst*

And just going forward, you mentioned there will be strategic investments, but is it going to be materially less than we saw this quarter? I mean, will we get a more normalized picture of things starting third quarter, or fourth quarter, or comment on that?

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

On the retail side, which is where the bulk of this is right now, on the retail side we expect to see some of this continue on into the third quarter but not at this level. So it is a little difficult for us to pinpoint exactly what that will be. But so we can't factor it out entirely. I don't believe that it will resume back to pre-existing levels. But we don't expect it to be as dramatic as this quarter because we don't have as much activity going on in the third quarter as we had in the second.

Keith Curtis - *Brant Point Capital - Analyst*

Okay, great. Thank you very much.

Operator

Karen Howland, Lehman Brothers.

Karen Howland - *Lehman Brothers - Analyst*

Thanks very much for the follow-up. I was wondering if you think about going forward in the second half of this year and next year, not as much on the remodel and conversion costs but how many stores in your plans right now do you expect to actually be remodeling or reformatting next year?

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

That's a great question, and that is something that we are reviewing right now. That is part of what we do during this, as you know this quarter is a longer quarter for us and during this period of time we actually go through a complete strategic review process, which will be ramping up here just in a couple of weeks. And specifically for that purpose and then we conclude that with a strategic planning meeting with the Board in September, and then we come to New York and discuss those plans in detail in November. So I don't really have an accurate number on that just yet, Karen, but by the time we are together in New York we will have a very specific and detailed plan behind that and can explain that to you entirely.

Karen Howland - *Lehman Brothers - Analyst*

Okay, and then just one other question on retail. I know you had mentioned that the switch from branded pharmaceuticals to generics impacted the comp. I was wondering if you could quantify that.

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

I don't know that I have any numbers right in front of me that will -- if our pharmacy guy was here he could probably speak to it generally, but I know weekly during our staff meetings it is a constant discussion about that, we actually track scripts by numbers, numbers of scripts. And we know how many of those scripts were filled with brands versus generics and what we know for sure is that the percentage of scripts being filled with generics versus brand is grown dramatically here year over year. So it could be that Bob could get a number back to you, Karen, but I don't have it right off the top of my head here.

Karen Howland - *Lehman Brothers - Analyst*

Okay, and do you think some of the food inflation -- I know obviously customers react differently, but I think across-the-board food inflation has been higher. Do you think that could be offsetting some of the, I guess the negative impact from the switch to generics?

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

It could be. That is always very difficult to know. I have been asked a lot over the years about inflation's impact on retail sales. I tend to think that the consumer has X number of dollars to spend at the grocery store, and when the groceries go up their dollar and their budget doesn't. And today I suspect that not only is their budget not going up, it is going down because of the pressures from fuel and other things that they are having to share those dollars with. So I have never saw a direct correlation between a 3% inflation rate and a 3% sales increase because of the things I've talked about. I don't think the consumer gets a 3% raise because food goes up by 3% and they have to make ends meet a different way, and I think the second is manufacturers react to inflation differently. Again, when cereal boxes get smaller but the price stays the same there is no impact at the cash register to that. So I just don't know that I can pinpoint very well a direct correlation between inflation and product in inflation at the cash register because of all the changes that goes on in the middle.

Karen Howland - *Lehman Brothers - Analyst*

But just using that example if the cereal box gets smaller don't people have to go buy cereal more often? Or does the bowl they actually fill get smaller, too?

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

You can make that argument, but they still buy one box of cereal when they go to the store. They don't buy two. And does that two ounces less, does that get made up over time? Perhaps; but we still only see one cereal box go to the cash register. So I don't know that I buy into that.

Karen Howland - *Lehman Brothers - Analyst*

Okay, thanks very much.

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

All right, thanks. Any other questions?

Operator

That was our final question in the queue. I turn it back to you for closing or additional comment.

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

Well, listen, I appreciate the opportunity to discuss our second quarter, and I look very much forward to joining the group in New York at the end of the third quarter. Remember this is a longer quarter, so you won't hear from us again until November. And we look forward to being there in person to talk about our third quarter results. Thank you very much.