

FINAL TRANSCRIPT

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NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Event Date/Time: Nov. 06. 2008 / 11:00AM ET

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

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Alec Covington

Nash Finch Company - President, CEO

Bob Dimond

Nash Finch Company - CFO

CONFERENCE CALL PARTICIPANTS

Karen Howland

Barclays Capital - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Nash Finch third quarter 2008 conference call. The Company has asked me to advise you that this call will include forward-looking statements which involve risks and uncertainties that could cause 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 and the Company's filings with the SEC, including its Form 10-K for 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.

Just as a reminder, today's conference is being recorded. 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 Company - President, CEO*

Thank you, Stephanie, and good morning everyone. Joining me today is our Chief Financial Officer, Bob Dimond, and our Chief Legal Counsel, Kathy Mahoney. It's a pleasure to be with you. We had hoped that we would actually do this particular presentation in New York. I think we had acknowledged that during the second quarter call, but the calendar and other pressing things just didn't allow us to do it, so we're actually doing a conference call today, but Bob and I hope to make up that visit and get up to New York and meet with many of our investors here in the not too distant future.

So with that, allow me to turn the meeting over to Bob Dimond, who will review the financial results and then I'll be back later to talk a little bit more about the quarter. Bob?

Bob Dimond - *Nash Finch Company - CFO*

Thank you, Alec, and good morning, everyone. Our total sales in the third quarter 2008 were up 5.1% to \$1.436 billion compared to the prior year's sales of \$1.367 billion. Year-to-date sales were up 1.1% to \$3.501 billion as compared to \$3.463 billion last year. As discussed on the last call, we passed the one-year anniversary of the transition of a large customer to another supplier at the beginning of the third quarter. As such, the third quarter sales were comparable but the year-to-date sales were still impacted. Excluding the year-to-date sales in 2007 attributable to this customer of \$72.8 million, total sales increased by 3.3%.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Net earnings for the third quarter 2008 were \$8.61 million or \$0.65 per diluted share. Net earnings for the third quarter 2007 were \$15.4 million or \$1.12 per diluted share last year. Net earnings for year-to-date 2008 were \$30 million or \$2.28 per diluted share. Net earnings for year-to-date 2007 were \$30.3 million or \$1.22 per diluted share.

I'd ask you to refer to the table on page 2 of the earnings release, which details the significant items that primarily affected net earnings and which only affected EBITDA to a very small extent. Please note the significant items which negatively affected 2008 net earnings by \$4.6 million or \$0.35 per diluted share during the quarter and by \$2.6 million or \$0.20 per diluted share in the year-to-date period. The primary item affecting both the 2008 third quarter and year-to-date periods resulted from a year-over-year increase in non-cash LIFO charges.

Compounding this issue, our 2007 net earnings benefited by a few significant items netting to a positive \$3.9 million or \$0.28 per diluted share during the quarter and by \$4.5 million or \$0.33 per diluted share during the year-to-date period. The primary items affecting both the 2007 third quarter and year-to-date periods were lower tax reserve requirements that were realized on the income tax line.

The materiality of these significant items has caused net earnings between the two years to not be comparable without adjusting for these items. After excluding these items, net earnings for the third quarter 2008 would have been \$13.2 million or \$1.00 per diluted share as compared to \$11.5 million or \$0.84 per diluted share in 2007.

Similarly, after excluding these items from the year-to-date periods, 2008 year-to-date net earnings would have been \$32.6 million or \$2.48 per diluted share as compared to \$25.8 million or \$1.89 per diluted share in the prior year period.

As you know, we provide a supplementary schedule at the end of our earnings release which details our quarterly EBITDA results in terms of consolidated EBITDA and you'll recall that one of our key financial targets in our strategic plan is to drive improvements in our EBITDA margin. With this in mind, EBITDA for the third quarter 2008 increased by 9.7% to \$44 million or 3.1% of sales as compared to \$40.1 million or 2.9% of sales for the third quarter 2007.

EBITDA for the year-to-date period in 2008 also increased by 9.7% to \$108.2 million or 3.1% of sales compared to \$98.6 million or 2.9% of sales in the year-to-date 2007 period. We're very pleased with the consistency of the quarter and the year-to-date increases realized in EBITDA, which have benefited from improvements in both gross margin and holding expenses in check.

Our consolidated gross profit margin was 8.5% of sales in the third quarter 2008 as compared to 8.9% in the same period last year. Gross margin was negatively impacted by the year-over-year increases in LIFO charges of \$7.3 million or 0.5% of sales and excluding this impact our third quarter gross margin was actually up 0.1% of sales.

Our year-to-date gross margins were 8.8% of sales as compared to 8.9% of sales during the same period of last year. The year-to-date gross margins were also negatively affected by incremental non-cash LIFO charges of \$9.2 million or 0.3% of sales. Excluding this impact, our year-to-date gross margin was up 0.2% of sales due to improvements achieved from better management of inventories.

Our consolidated selling, general and administrative expenses as a percent of sales for the third quarter 2008 were 6.3% and were relatively flat to the 6.2% of SG&A realized last year. SG&A expenses as a percent of sales for the year-to-date 2008 period were 6.2% and flat as a percent of sales to the year-to-date period for 2007 of 6.2%.

Now I would like to drill down into each of our business segments. The following is breakdown of sales by each segment for the quarter. Sales in our food distribution segment were \$839.9 million in the third quarter this year, up 3.7% compared to \$810.3 million last year. And year-to-date sales in our food distribution segment were \$2.034 billion, down 1.2% from \$2.058 billion last year. Excluding the decline in sales of \$72.8 million relating to the customer who transitioned last year, year-to-date sales for the food distribution segment were up 2.5% compared to the same period last year.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

The sales momentum in our military segment continued to be strong in the third quarter with sales of \$410.4 million in this year's quarter, up 9.1% versus \$376.1 million last year. Our retail segment sales were \$186.2 million in the third quarter 2008, up 3% as compared to \$180.7 million last year. Our retail same-store sales increased 0.7% in the third quarter 2008.

So in summary, we're very pleased to see positive sales comparisons across all three of our business segments which collectively increased total company sales by 5.1% for the third quarter of 2008 versus 2007.

The following is a breakdown of EBITDA by business segment for the third quarter 2008. Our food distribution segment EBITDA was \$32.8 million or 3.9% of sales in the third quarter 2008, a 3.4% increase as compared to \$31.8 million or 3.9% of sales in the third quarter of 2007.

EBITDA in our military segment was \$15.7 million or 3.8% of sales in the third quarter this year, an increase of 20.6% versus \$13 million or 3.5% of sales last year. In our retail segment EBITDA for the third quarter 2008 was \$9.4 million or 5%, up 19.5% as compared to \$7.9 million or 4.4% of sales in the third quarter of 2007.

In summary, we are also pleased with the solid EBITDA performance company wide, which was up 9.7% for the quarter and year-to-date periods and was up 20 basis points to 3.1% as a percent of sales versus 2007.

I'd like to comment regarding our progress towards the long-term key financial targets identified in our strategic plan. As you'll recall, one of our 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 de-lever 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 all of these metrics.

Our EBITDA margin has improved from 2.2% to 3.1% of sales and our leverage ratio of total debt to EBITDA has improved by over a full turn of EBITDA from 3.42 times in 2006 to 2.3 times. Our ratio of free cash flow to net assets, excluding strategic projects, improved to 7.9% during the trailing four quarters. This is still down from our 10% target this year due to having a higher investment in inventory as compared to last year.

Important to note is during the third quarter of 2008 our organic revenue growth was 4.2% and was positive for the first time since we instituted our 2% organic growth target. We expect to make continued progress on these metrics as we implement initiatives associated with our strategic plan. As we progress towards delivering on these long-term targets, we believe this should translate into driving significant shareholder value.

Regarding liquidity, total debt decreased by 8.8 million during the third quarter to \$318.3 million. At the end of the quarter we had \$135.1 million of debt outstanding on a revolver and had \$149.6 million of availability under that facility. Our leverage ratio of total debt to EBITDA was 2.3 at the end of the third quarter, which improved from 2.42 at the beginning of the year.

The Company was in compliance with all debt covenants at quarter end. The Company has a strong balance sheet. Our bank lending group is in tact and our access to credit under our bank revolver has not been affected by the credit crisis. The Company announced on Tuesday that our Board of Directors had declared a regular cash dividend of \$0.18 per share to be paid on December 5, 2008.

I'll now turn the call back to Alec.

Alec Covington - Nash Finch Company - President, CEO

Thank you, Bob. I think as we ended the third quarter, I guess my reaction to it was that there are few times that I remember in my career in running these companies and being parts of these companies that you had all positive indicators in all of your

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

business units. And this is a rare moment in time and one that we'll savor for a while, recognizing that it isn't always that way. But we'll take it at this time.

I think the headline for us for this quarter is that the Company is growing again and that's so important, because companies that don't grow eventually die. And we had tremendous challenges in reenergizing the growth at Nash Finch, back when we started in 2006, but listen, we're there and we're pleased to be in that position. You have 5.1% growth factor for the entire company and 3.7% growth in food distribution, which at one time was the most troubled part of our business; 9.1% in military.

Military has always been an excellent performing business. But listen, 9.1 is even higher than they've been able to do, as good as they are in recent years and we're very proud of them. And then a 3% growth in our retail business. Now that 3% growth is primarily attributable to the new stores that we acquired from Albertson's here, but still, when you look at even the positive same-store comp sales, listen, 0.70 is not exactly claiming victory. We understand that. But looking at our history and our difficulties in retail, being positive by 0.70 is something that we're quite proud of, given where we've come from in the past.

And then to look at our EBITDA performance to see the top line and the bottom line going in the same direction in all of our businesses. A 9.7% increase in bottom line EBITDA against a 5.1% increase in top line for the entire company is quite encouraging to us. 3.4% in food distribution. 20% increase in bottom line EBITDA in our military business and a 19.5% improvement in bottom line improvement in EBITDA in our retail business. Those are numbers that we'll take, obviously.

Now, as Bob mentioned, our earnings per share was heavily influenced by LIFO. Frankly, I'm sure that there will be those that take issue with me on this, but my position is LIFO is our friend. LIFO is a mechanism that allows us to avoid paying unnecessary income tax on inflationary gains in our inventory. So, we don't try to fight LIFO. We appreciate the opportunity to take that additional expense and not be taxed unfairly and unnecessarily on the inflation in our inventories. It's all non-cash, but it is impactful to the actual cash that we would have otherwise paid in income tax had we not been able to take that charge. And so again, my position is when you really look at the right way to run a business, LIFO is not an enemy, LIFO is our friend.

Now again, you know, we also saw the reversal of a tax credit that we got last year. As I've said before, I think we have a brilliant tax department under the leadership of Paul Bischel and that whole group is just phenomenal in what they do. I wish we could get a \$4.9 million credit every year, but I'm realistic and understand we can't. So we have to understand those two influencing factors and we do the math properly and look at our earnings per share it tells you that we actually increased it by 18% from \$0.84 to \$1.00 a share. Not bad in the times that we're in today.

As Bob mentioned, something that we're not only proud of, but we're very thankful for, is the strong balance sheet that we have. Our leverage ratio is at 2.3 and dropping. We have plenty of liquidity and credit availability and we're very well positioned to take advantage of market opportunities that may appear during these difficult financial and economic times.

As Bob mentioned, we have taken our targets very seriously. We have longed for the day when we could see ourselves as a growth company. This quarter, of course, we exceeded our 2% growth target and we're very proud of that. I remember back in 2006 when we were in New York making the initial presentation of Operation Fresh Start, I announced our ambition and desire to grow our EBITDA to 4%, when at that point we were sitting at 2.2 and I got some interesting looks from the audience at that moment in time. And listen, we're not at 4% today, but we've crossed over the threshold of 3%, we're above 3 now and we're incrementally heading toward that goal with our existing business as we head towards the future.

Our free cash flow target, one of the things that we need to recognize in the free cash flow target is that when we set that target of 10%, we weren't wise enough to anticipate the extraordinary level of inflation that would occur in our inventories, and that really is the major contributing factor to the myth against that metric. And we'll need to carefully examine that in the future and try to understand is there something that we need to do differently to react to that.

But what I will tell you is that if you exclude the strategic capital, which we had announced earlier we would spend in order to complete an additional stage of Operation Fresh Start. If you set aside that strategic capital and also if you take into the effect

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

the inflation that is existing in our inventories, we actually did achieve a 9.2% return on our free cash flow metric and that's at a point in time in the year where inventories would naturally be higher heading into the holiday period. And of course as Bob mentioned, our debt ratio is clearly better than what we had targeted.

As we look ahead to the fourth quarter, again we get to savor the enjoyment of the third quarter for about 30 seconds and then we need to head into the fourth and think very carefully about how we run our business, given the environment that we're in. I think that as we look at our business today, we have to understand that we have a 53rd week, of course, that will occur in the fourth quarter. When you set that aside, setting aside the 53rd week, we expect that our overall company sales improvements will be strong in the fourth quarter as it was in the third. It might even be a little bit better and I'll tell you why. We are experiencing some extraordinary export shipments in our military division, which are not normal for this time of year. Therefore, with that we believe that we'll actually ramp-up just a little bit perhaps in our sales increase year-over-year from the third quarter to the fourth quarter.

We also expect -- we don't see any reason why that we should see our retail comp store sales get any worse. They should be comparable. It could be a little bit worse, a little bit better, but I don't think to any big degree. I don't think it's going to get dramatically better, I don't think it's going to get dramatically worse in the fourth quarter. We expect to hold constant in that general range.

Now we do expect that because our military business will be a larger percentage of our volume in the fourth quarter of 2008 than it was in 2007, it's logical to expect that our actual EBITDA margin may go down just a little bit, simply because of the percentage of sales which will be coming from our military segment in the fourth quarter of this year that's different from the fourth quarter of last year and the growth that that group has experienced.

And then finally, LIFO again -- boy, I wish I had a crystal ball and had some idea of how that would end up at the end of the year, but that's impossible to do, because as you probably are aware, LIFO is a function of the mix of inventory that you had at the end of the year and how that relates to the inflationary factors that have occurred.

But here's what I can tell you, LIFO is not going away in the fourth quarter. I don't expect it to be as high as it was in the third quarter. If things remain the same as they are right now with our current trend and rate, we would expect that we could see as much as \$4 million. We would hope that it would be higher than that. That would bring the year-end totals closer to the 16. But let's be clear, nobody that I know of could possibly forecast LIFO. It could be higher or lower than that. My point in bringing it up is that it doesn't go away in the fourth quarter. But again, it is non-cash. It serves as a function to make sure we don't overpay income tax, which we're all for. But just be aware of that.

And then as we look at 2009, again, we'll be compared to a 53rd week, and so we have to set that aside, but when we exclude the impact of the 53rd week, I expect -- it's my belief and my hope that our growth will be in excess of our target for the full year. I think the way I would expect to see that occur is heavier in the first half than the second half, because we have so much business that we brought onboard here in the last few months that we're going to have and be competing against that for the first half of next year. Then of course that will temper some. And by the time we end the entire year, I would expect we would still exceed our target of 2%, but probably not at the rate that we're running right now. But again, that's anybody's guess, but that's what we can see at this moment.

As I look at our EBITDA margins, I think one of the things that we have to keep in mind from 2008 to 2009, is the fact that we did have strong inflation in our inventories which actually enhanced our gross margins during 2007 and we're not expecting to see that same level in 2009. Therefore, I think that as we look at the year ahead, we still believe that we can see some incremental -- minimal incremental improvement in our EBITDA rate, but it's not going to be huge. We're going to have to overcome the effects of the inflation that is in our inventories this year and that's going to be tough and we're up to the task. But, I think we can expect to see some minimal incremental improvement in our EBITDA rate, but not anything of any significance going into 2009.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Now as we stop for a moment and talk about capital, I'll take you back to last year at this time, we indicated that we would spend about \$50 million in total in capital by the end of 2008. We divided that into two pieces, about half of that was going to be maintenance capital at 25 and about half of that was going to be strategic capital, because if you'll recall, we wanted to invest in our Avanza stores and some into our warehouse facilities and things that we needed to do in order to keep our results improving.

As we look at the way that we end the year, there are several of those projects that became delayed for various reasons. In some cases it was permitting and other things that were beyond our control. And some of those projects will actually rollover into 2009. So as we look at where we intended to end the year, we intended to spend about \$50 million in capital. It looks like we'll probably spend somewhere closer to 35, with a good part of the balance of that capital rolling over into 2009.

Now, as a result of that, that means that our budgeted capital or the capital that we anticipate spending will be more in the \$60 million range in 2009, because we have to provide for the additional capital that we didn't get to spend in 2008 on some of the projects that are still underway.

When you really balance the two years of 2008 and 2009, you'll see that we'll spend even less than the \$50 million that we thought we would spend in 2008, but clearly we're going to see an increase because of some of the carryover projects, that's one thing, and then we'll see a bit of an increase in strategic capital, so that we can invest at a more accelerated rate into some of the things that are really providing excellent returns to our business.

Now when we look at that \$60 million for 2009, we believe that our maintenance capital will run somewhere in the same range. We've already said that maintenance capital for Nash Finch ought to be somewhere in the \$25 to \$30 million range and we've said that now for several years. We still believe that. That means that the balance of 30 to 35 will be in projects that will generate an IRR, a return in excess of our 15% threshold. And we demonstrated in 2008 with our results that we know how to do that. And some of those projects have returns even greater than what we had anticipated.

So, as we look at 2009 with our new project plans, there are several things that we hope to achieve. First of all, we have some major enhancements that we intend to put into our billing system within our food distribution business. This is an element that is necessary to help support our Center Store program and to align our billing system and practices across our overall company. That's very important in providing consistency and being able to manage our billing more properly and better support our Center Store program. So that project is underway now and we'll spend some capital on that during 2009.

We also believe that it's now time to move toward having some improved demand planning capabilities that is designed to assist and even improving further our inventory management. I think we've done a good job in managing our inventories, frankly. But I think that there is more we can do by better anticipating the promotional activities from our customers and making sure we have enough product, but not too much product to support those efforts. So demand planning is key to that. It will have a good payback for us if we can do it properly. We're exploring a system to help us do that now and it's our plan to deal with that in 2009.

And then the third item that will take some capital next year is a really good thing. We need to expand one of our facilities to accommodate the additional growth that we're experiencing out in the Great Lakes area. As we have continued to make changes with Lima and some of our facilities out there, we're just experiencing a lot of growth. And we have now exceeded the capacity or will soon exceed the capacity of the facility there, so we'll be doing some physical plant expansion there simply to accommodate growth.

As you know, we've experienced some really great results with our Avanza format during 2008. I spoke to you earlier in the year about the tremendous results we had when we made the conversion of one of our stores in Omaha and that we followed that up by another store in Greeley that also has exceeded our expectations. Well listen, we want to do four more of those next year, so we're going to do four additional Avanza stores. These will not be conversions of our existing stores. These will be locations that we will have identified across our marketing area, where there are simply opportunities to expand Avanza into new markets.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

We also hope to do one of our corporate store conversions to the Buy n Save format. That is our rural format that we use in more rural markets. It's a little smaller size, 30,000 square feet or so and it's more of a price oriented format and value format. It matches up very well with the economic circumstances that we find ourselves as a country in today.

And then we plan to do two additional conversions to the Family Fresh market. Now, the Family Fresh Market is the format that we use with the most recent conversion that we completed back at the end of the second quarter in Hudson, Wisconsin. That store has had phenomenal consumer reaction. We don't know much about the overall operating statement, because it hasn't been opened very long, but what we do know is that the consumer reaction has been phenomenal. We know that the sales projections are exceeding anything that we thought was possible.

We actually had the plans to do an additional Family Fresh Market during 2008, but because of permitting and we own the real estate in that location and we had to buy some additional property and houses around us, that project got delayed. So that's one of the projects that gets moved to 2009. So we'll complete that one in 2009 and we'll do one additional Family Fresh Market during 2009.

Now those are really the key strategic items for capital in 2009. I don't see us spending any more than the \$60 million. Again, that's a \$10 million increase over the budget for 2008, mostly to accommodate things that we didn't get done in 2008, but again, a little bit to accelerate some of our investments in Avanza that are paying big dividends for us.

But also as we head into 2009, similarly to 2008, we believe that we should be focused on strategic acquisition opportunities as they come along, as they make sense. We believe that we're in an economic climate right now, where if you have a strong balance sheet and you have credit availability, you're a pretty good looking partner to somebody who is looking for a potential exit strategy. So we're looking at opportunities whereby companies would match our strategic growth plan, that fit, that are clearly accretive and that do not put us in any high level of risk, so we'll be very diligent, very deliberate in our efforts there, conservative in that as we've always been, but if we have the right opportunity come along as we've done in our pursuits in 2008, we'll continue to look into 2009 to see if any of those things would make sense.

Now in summary, I think first of all Operation Fresh Start, which we started January 1, 2007 appears to be helping us. It appears to be working, even though it's in its infancy and it's helping us to achieve our growth related goals. And we're pleased with that. Our new Avanza stores continue to outperform our expectations, both in top line and bottom line EBITDA performance. Our Family Fresh Market that we opened in Hudson has by far exceeded our growth expectations and the consumer reaction to that has been incredibly positive.

Our Center Store initiative that we launched over 1.5 years ago continues to post excellent results in terms of growth and will soon be ready to rollout to some of our other facilities in 2009. And that's something we've been waiting for, for quite some time and our other facilities and our retailers are anxious to see the benefit of those category management strategies to their cost of goods.

Our upstream/downstream facility that we talked a lot about that helps us to take cost out and become more efficient in distribution in a region. That facility, located in Bellefontaine, Ohio is essentially complete. It's ready to begin its operations shortly after the 1st of the year. We had to delay that because of a good thing. We delayed it because we had so much new customer activity going on out there we didn't want to compromise our customer service by having our folks focused on this new facility, so we delayed it until after the 1st of the year. Get through the onboarding of these new customers as well as the holidays and it's our plan to ramp that facility up just shortly after the 1st of the year, but it is essentially ready to go.

We continue to be quite proud of the performance of all of our business segments, particularly the new customer additions in our core food distribution business. We remain committed to the growth and expansion of our military business and we're extremely proud of the job that our team and MDV is doing in supporting the commissary privileges that are so important to our military families that are serving both domestically and abroad.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

You know, I was just at a large convention and meeting in our military business. It's called the ALA, the American Logistics Association. That meeting was held just a few weeks ago in Washington, DC. At that meeting I had the opportunity to meet with the major representatives and executives of DeCA, which is the Defense Commissary System. I had the opportunity to meet with many of our largest customers. In fact, I was able to talk to the representatives of companies representing well over half of the business that we do.

And one comment -- it was just comment after comment that I walked away from there feeling so proud of the job and the compliments that were paid to the team at MDV. But one particular customer happens to be one of the largest customers we have, he says, Alec, here's what I want you to know about your MDV company and Ed Brunot on the team out there that runs that. We have a ranking system that we use to rank our distributors across the country and the world and the ranking goes from 1 to 4. If we had a ranking higher than 4, we would give it to MDV, because you are that good. So that was wonderful to hear.

Now listen, we believe that this has been a great quarter for us, but you don't always have great quarters and we know that as good as this feels, our team fully recognizes that we still have an enormous task in front of us in fully implementing Operation Fresh Start and that the road ahead with us will, like any other business, will be faced with challenges, setbacks and disappointments. But let me tell you, we've got a team that's ready to face it. We have a team that's steadfast in their determination to achieve these goals and I think we're ready to meet the challenges in front of us, even in this challenging financial and economic time.

So with that, Stephanie, if I could ask for your help, I'd love to take some questions from the group if we have some today.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Karen Howland with Barclays.

Karen Howland - Barclays Capital - Analyst

This is probably a dumb question, but does foreign exchange impact your international military business at all or is it all in US dollars?

Alec Covington - Nash Finch Company - President, CEO

It really doesn't have any impact at all. The only thing that the foreign exchange rate has in terms of impact is because the euro has been so expensive to the dollar, it has caused more of our troops in Europe to spend more dollars on the base, because they're able to get a better value in the commissary than obviously they could get off the base with the challenges with the euro. So no, it has no impact to us except that it does have the impact of keeping more soldiers on the base and spending more dollars in the European commissaries.

Karen Howland - Barclays Capital - Analyst

That's what I figured. I just wanted to confirm that. And then, thinking about your distribution business, I know and you commented that the inflation has been a benefit for you for this past year. Can you remind me what happens to both your retail as well as distribution business in a deflationary environment?

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Alec Covington - Nash Finch Company - President, CEO

I think it's the same of us of any retail distribution environment, I mean a deflation environment you have the reverse scenario that you have to manage through. You would have declines in product value. So those are things that we manage very carefully. In a deflationary environment we work very hard to secure what we refer to as floor stock protection, so that if we have product where a manufacturer takes a price decrease, we ask the manufacturer to support us in the on-hand inventory that we have. That's called floor stock protection. And so we've been pretty successful with that over the years. But yes, it in essence has some of the reverse kinds of trends.

In the retail side, we're in a high inflationary period and a tough economic time you have people running toward private label. When the reverse occurs then you can have people who see national brands it becomes more attractive, things they couldn't have afforded that otherwise now they can. So, it really works contrary to one another.

Karen Howland - Barclays Capital - Analyst

And so would the move away from private brands in retail offset any benefit you might see from people just having more money -- being able to buy more volumes?

Alec Covington - Nash Finch Company - President, CEO

Maybe I'm not understanding the question fully. We're talking about, I think deflation and what would happen if we came into a deflationary time. Obviously we're not seeing any signs of that. And let me be clear, we don't see any indications and the vendors have not given us any indication of that, that we should expect that in 2009 either. And I can't point to a period of time in my career where I really saw a huge deflationary period of time that I can reflect upon.

What I can tell you is, in tough economic times as we are having right now and high inflationary times as we have today and as we've had throughout the year, we have seen a tremendous growth in our private label products. We saw, as an example, a lot of trading down in our pharmacy area, to procuring -- more of our consumers buying cheaper generic products. In a deflationary time, I guess you could see the reverse, but frankly I don't have a lot of experience in experiencing that and I don't expect to experience it any time soon.

Karen Howland - Barclays Capital - Analyst

And so you have any idea of how much of a benefit in the third quarter -- inflation benefited your distribution business?

Alec Covington - Nash Finch Company - President, CEO

In our third quarter, as I look at it, I think it was more about growth. It was more about the business that we brought onboard and more about being able to tow the line on expenses. We just manage our inventories for what we need to serve our customers and we don't really have a specific amount that we believe was contributing to inflation. We know it's there, but I think in the third quarter our results had more to do with our growth and our sales than anything else.

Karen Howland - Barclays Capital - Analyst

And turning to that growth that you saw in distribution, can you give an understanding of how much of that is actually new customers versus how much is existing customers buying more product?

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Alec Covington - Nash Finch Company - President, CEO

There is as piece of it that is existing customers buying more. The lion's share of it though, frankly, is additional customers that we've gained within the last several months. So that would be the bulk of it.

Karen Howland - Barclays Capital - Analyst

And do you feel you're winning these customers price, service, anything differentiated that you're doing compared to your peers?

Alec Covington - Nash Finch Company - President, CEO

The growth is coming from all different directions and it's even geographically spread, even though I would have to admit that the growth may be greater in the Great Lakes area where we've got a lot of our Operation Fresh Start initiatives more rolled out. But as we listen carefully to what customers are telling us, I think that -- we took a stand back in 2006, that I would say some probably thought was risky and that is that we stood up and said we're going to hang our hat on the success and the dedication to independent retailers and independently owned chains and I think that that took a while to resonate throughout the marketplace, but I think it's a big driver behind our growth today, the fact that that's all we do. We give an incredible amount of attention. We spend a lot of time.

As the CEO of this company I spend a lot of time with our customers trying to help them develop strategies to grow and I don't think that that's all that common in the business today and I think that it's recognized, that we're a much stronger company focused on their needs than others. As an example, we had an outside company that did a survey of 16 of our largest customers and they were probing around the areas of service and price and trying to get a balanced approach to understand how well we're doing. Those surveys came out extremely well. So I think even our existing customers see us performing better on block and tackle relative to cost of goods and service, than perhaps they did back a few years ago. So there's that, but I think the overriding thing that we hear from customers coming into our network is that they're just looking for somebody who's really interested in their type of business, which is not as prevalent today as it was years ago.

Karen Howland - Barclays Capital - Analyst

Thanks very much and congrats on a good quarter. It's rare to see this in this environment, so congratulations.

Operator

(OPERATOR INSTRUCTIONS) Follow-up from Karen Howland with Barclays.

Karen Howland - Barclays Capital - Analyst

Looking at the retail business, the margin was quite strong. Is that primarily sales leverage or is there anything that you all were doing to drive that margin this quarter?

Alec Covington - Nash Finch Company - President, CEO

Well, I think part of it is the mix of business that we have in some of our stores that we've remodeled and we sanded, Karen. I think that if you look at a store that used to be a conventional store and then in the case of Omaha we convert it to an Avanza. The Avanza format has a radically different product mix with a huge -- enormous distribution in produce and meat that has higher margins than the Center Store.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

When we remodeled the Hudson, Wisconsin store, we actually dropped the retail prices in the Center Store by a wide margin in order to make sure we were competitive with large box retailers. And the only way we were able to overcome that was the fact that our perimeter sales in our deli and bakery -- our produce there, if I recall properly, is up like 46%. Our deli is up over 60% in sales. So when you look at those kinds of dramatic increases in perimeter volume, it has a huge impact on the overall gross margin.

Now, in addition to that, I think the team has done a really good job. They did make some changes in some of their marketing approaches this quarter, which I think paid good dividends and I think they're doing a better job with inventory management in those facilities. So I think it's a combination of things, but it's also highly driven by mix.

Karen Howland - *Barclays Capital - Analyst*

And is it safe to say that the sales growth that you guys saw in the same-store sales is primarily being driven from the remodeled stores you've done?

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

The comp store growth is heavily influenced by the remodels. Even so, what's interesting to us is if we look at the balance of stores that haven't been touched, they've actually improved as well, and that's the marketing efforts and what Mike Mills and his team have done in better managing their merchandising plans. But clearly, we don't have a huge retail business, so when you've got the Hudson store and several of these Avanzas that are clicking along at well over double-digit increases, it has a tremendous influence on the comps.

And then the outright year-over-year growth that we've experienced is really more attributable to the new stores that we didn't have a year ago, which were the Albertson's stores we bought in Scottsbluff, Nebraska and Rapid City, South Dakota.

Karen Howland - *Barclays Capital - Analyst*

And you talked about some of your CapEx being delayed, about \$15 million worth of CapEx. Can you talk a little bit about what exact projects you are pushing out until next year?

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

They're mainly in retail, where we had our facility over in New Richmond here that is a facility that we own. It was slated to be a Family Fresh Market open right now. And frankly, it just took an enormous amount of time with permitting. We had to buy three houses and we had to try to get a road closed and work with the city and all the various requests that came in from the locality. And it just took a tremendously long period of time. Now we got it done and it's under construction now, but our intent was to have it open.

So that's a big part of it, but there were other things where we spent some capital, as an example, for some of our Center Store projects, some of that capital got spent in 2008, but then it rolls over into 2009. So some of it is partial capital that we still need to spend in 2009 to complete projects that got started in 2008. And there's a long laundry list of those. I would tell you that the retail store side is a big part of it, in addition to the additional stores that we want to build to accelerate the expansion of Avanza in 2009.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Karen Howland - Barclays Capital - Analyst

And then finally, turning to the acquisition front, I know last time we chatted you mentioned that you were looking for acquisitions but it seemed that people were expecting higher multiples, higher prices that what you guys thought was appropriate. Have you seen that change at all? Are people a little bit more willing to talk and to negotiate?

Alec Covington - Nash Finch Company - President, CEO

Here's the way I would characterize it, Karen, broadly, is that in 2007, which is when we really started to focus on this, capital was incredibly cheap. A lot of, in my view, unrealistic deals were being put together and people were talking about 10 times EBITDA and you don't get my attention for very long talking to me about 10 times EBITDA or anywhere close to that. So, Bob and I decided we're going to sit on the sidelines because we didn't have faith that those kinds of deals were sustainable and doable and would ever be ultimately accretive. So, that forced us on the sidelines in 2007.

Now in 2008, what we're seeing is very interesting. If you look at it, common sense would say well the multiple has been depressed in 2008. Frankly, I haven't seen that. What I've seen is good companies that would have otherwise sold in 2007, are just sitting on the sidelines, high-quality companies that may have considered being part of an acquisition are sitting on the sidelines because most people aren't paying the logical multiples or they can't get the financing. But good high-quality companies didn't all the sudden decide that they're going to sell at a multiple of 4.5 because the credit market slipped. They decided that perhaps it's not a good time to sell.

On the other hand, companies that are desperate, companies that are in trouble, yes, those multiples perhaps are lower than we would have seen in 2007. But to be honest, those are not the type companies that Bob and I would have tremendous interest in. We're looking at high-quality companies with strong management that have good franchise. And those are not the companies, generally, that are facing credit crises and are facing those kinds of challenges. So you either have to still buy those companies maybe not at an outrageous multiple that you would have seen in 2007, but you've still got to pay a fair price for them or they ultimately decide that it's just not a good time to sell. That's kind of the way we're seeing the market right now.

Karen Howland - Barclays Capital - Analyst

So the good companies that you would be interested in buying, you're not willing to pay the 10 times that they demanded let's say in 2007 and they haven't reset their expectations down to -- I mean, nothing is getting done at this point, but more that the public companies are trading at four to five times and it's going to take some time until you meet somewhere in the middle?

Alec Covington - Nash Finch Company - President, CEO

I don't think that was the way I quite intended to characterize it, if I did. But what I was saying was is that from 2007 to 2008 -- good companies didn't all the sudden decide to sell at a discounted price. Maybe they're looking at it more realistically and realizing the 10 times -- the outrageous deals that got done, in my view anyway, in 2007 aren't repeatable. But they haven't dropped all the way down into the discount range, into the four and five range. They're just either sitting on the sidelines or they're having discussions.

I don't think the issue with acquisitions is so much the ability of companies to acquire, I think the bigger challenge for most companies with acquisitions is the availability of credit and that's where we are in a great position, frankly, in this environment. So, that would be about all I would know to say on that topic, Karen.

Karen Howland - Barclays Capital - Analyst

All right, thank you very much.

Nov. 06. 2008 / 11:00AM, NAFC - Q3 2008 Nash Finch Company Earnings Conference Call

Alec Covington - Nash Finch Company - President, CEO

Any other calls, Stephanie?

Operator

No, sir. I'll turn the conference back to you for any additional or closing remarks.

Alec Covington - Nash Finch Company - President, CEO

Okay. Well listen, we appreciate the time here this morning. We wish everybody a wonderful holiday season as we head into the holidays, because it will be after the 1st of the year, obviously, before we speak again. And from our side, we're most thankful to enter this holiday season as a company that's in solid financial condition with a balance sheet prepared to weather the difficult economic and financial environment that we're in, and we're very thankful for that. So with that, thank you and we look forward to talking to you next time.

Operator

That will conclude our teleconference. Thank you all for your participation. Have a great day.

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