

# FINAL TRANSCRIPT

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## **NAFC - Q4 2008 Nash Finch Company Earnings Conference Call**

**Event Date/Time: Mar. 12. 2009 / 11:00AM ET**

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## CORPORATE PARTICIPANTS

**Alec Covington**

*Nash Finch Company - President, CEO, Director*

**Bob Dimond**

*Nash Finch Company - EVP, CFO and Treasurer*

**Kathleen McDermott**

*Nash Finch Company - SVP, General Counsel and Secretary*

## CONFERENCE CALL PARTICIPANTS

**Karen Howland**

*Barclays Capital - Analyst*

**Blaine Marder**

*Loeb Partners - Analyst*

**Mason Stark**

*Ramius Capital - Analyst*

## PRESENTATION

**Operator**

Good day, everyone. Good morning, ladies and gentlemen, and welcome to the Nash Finch fourth quarter fiscal year 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 actual results to differ materially from those expressed in forward-looking statements. Factors that could cause such differences are described in the Nash Finch press release and in the Company's filings with the SEC including its form 10-K for fiscal 2008.

The Company also notes that the call may include references to certain non-GAAP financial measures as the term is used in SEC regulation G, such as consolidated EBITDA. Reconciliations of non-GAAP financial measures to the most comparable GAAP financial measures are provided 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, Mr. Alec Covington.

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

Thank you Mark and good morning everyone and welcome to our conference call and our earnings call for the fourth quarter fiscal year 2008. Joining me this morning is Bob Dimond, the Company's Chief Financial Officer and Kathy Mahoney, the Company's General Counsel. As we've done in the past, I'll first turn the meeting over to Bob Dimond, who will go through the financial results and then when he has completed that, he will turn it back to me and I have a few comments regarding the fourth quarter and 2008 and a few comments also regarding 2009. So with that, Bob, go ahead.

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**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

Thank you, Alec and good morning, everyone.

Our total sales in fiscal year 2008 were up 3.8% to a record \$4.704 billion, compared to prior-year sales of \$4.533 billion. Fiscal 2008 consisted of 53 weeks, compared to 52 weeks for fiscal 2007. As we have previously discussed, the fiscal 2008 sales were

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impacted in the first half of the year by the transition of a large customer to another supplier in mid-2007. And after adjusting for the 53rd week of extra sales of \$77.1 million and excluding the fiscal 2007 sales attributable to this customer of \$72.8 million, total Company sales increased by 3.7% on a 52-week comparable basis.

Sales for the 13-week fourth quarter were \$1.203 billion compared to \$1.069 billion in the 12-week prior-year quarter, an increase of 12.5%. Excluding the sales attributable to the extra week, sales would have been \$1.126 billion or up 5.3%.

Net earnings for fiscal 2008 were \$36.2 million or \$2.75 per diluted share, compared to net earnings of \$38.8 million or \$2.84 per diluted share in fiscal 2007. Net earnings for the fourth quarter 2008 were \$6.2 million or \$0.47 per diluted share, compared to net earnings of \$8.5 million or \$0.62 per diluted share in the same period last year. Net earnings for both the fiscal year and the quarter were affected by several significant items. I'd ask that you refer to the table on page two of the earnings release, which details the major items which affected both net earnings and EBITDA. Please take note of the significant items which negatively affected 2008 -- net earnings, by \$6.1 million or \$0.46 per diluted share and \$3.5 million or \$0.26 per diluted share in the fourth quarter.

The primary item affecting both the 2008 fiscal year and fourth quarter periods resulted from a year-over-year increase in non-cash life -- LIFO charges. Further compounding this issue, our fiscal 2007 net earnings benefited by a few significant items netting to a positive \$4.3 million or \$0.31 per diluted share during 2007. And our fourth quarter was negatively impacted by about \$200,000 or \$0.01 per diluted share for -- in 2007.

The materiality of these significant items has caused net earnings between the two years to not be comparable without adjusting for these items and after -- once excluding these items, net earnings for fiscal 2008 would have been \$42.3 million or \$3.21 per diluted share, as compared to \$34.5 million or \$2.53 per diluted share in 2007. Similarly, after excluding these items from the fourth quarter periods, 2008 fourth quarter net earnings would have been \$9.7 million or \$0.73 per diluted share, as compared to \$8.7 million or \$0.63 per diluted share in the prior-year period.

We provide a supplementary schedule at the end of our earnings release which details our quarterly EBITDA results in terms of consolidated EBITDA. You recall that one of key financial targets in our strategic plan is to drive improvements in our EBITDA margin. And with that in mind for fiscal 2008 it -- EBITDA increased by 11.6% to a record \$143.7 million or 3.1% of sales compared to \$128.8 million or 2.8% of sales in fiscal 2007. EBITDA for the fourth quarter of 2008 increased by 17.5% to \$35.5 million or 3% of sales, as compared to \$30.2 million or 2.8% of sales for the fourth quarter of 2007. We remain committed to our core businesses and are particularly pleased with our 2008 accomplishments in both terms of sales and EBITDA.

Our fiscal 2008 gross margins were 8.7% of sales, compared to 8.8% of sales during this same period last year. The gross margin was negatively affected by incremental non-cash LIFO charges of \$14.6 million or 0.3% of sale. And excluding this impact, our fiscal year 2008 gross margin was up 0.2% of sales due to improvements achieved from better management of inventories. Our gross profit margin was 8.1% of sales for the fourth quarter of 2008, as compared to 8.4% in the same period last year. Our gross margin was negatively impacted by year-over-year LIFO increases -- or -- or LIFO charges of \$5.5 million or 0.5% of sales. Excluding this impact, our fourth quarter gross margin was also up 0.2% of sales compared to the prior year.

Our consolidated selling general and administrative expenses as a percent of sales for 2008 were 6.1%, flat in comparison to 6.2% of sales in fiscal 2007.

SG&A expenses as a percent of sales for the fourth quarter 2008 were 6% and were unchanged to the 6% of sales realized last year.

Now I'd like to point out a few items in each of our business segments. Year-to-date sales in our food distribution segment were \$2.741 billion, up 1.8% from \$2.693 billion last year. And excluding the 53rd week of sales of \$45.3 million and adjusting for the decline in sales of \$72.8 million relating to the customer who transitioned to a new supplier in mid-2007, fiscal 2008 sales for the food distribution segment were up 2.9%, compared to the same period last year. Sales in our food distribution segment

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were \$706.4 million in the fourth quarter this year, up 11.2% compared to \$635.2 million last year. Excluding the 53rd week of sales of \$45.3 million, sales were up 4.1%, compared to the fourth quarter of last year.

The sales momentum in our military segment continues -- continued to be very strong in fiscal 2008 with sales of \$1.361 billion in this fiscal year, up 9.1% versus \$1.248 billion in last year. Adjusting for the 53rd week of sales of \$20.5 million, sales increased 7.4% relative to last year. Fourth quarter military sales were \$348.5 million in this year's fourth quarter, up 16.5% versus \$299.2 million last year. And adjusting for the extra week of sales, sales increased 9.6%.

Our retail segment sales were \$602.5 million in fiscal 2008, up 1.8% compared to \$591.7 million last year. And adjusting for the extra week of sales of \$11.3 million, sales were relatively flat, compared to fiscal 2007. Our retail sales segment where -- sales were \$148.1 million in the fourth quarter 2008, up 9.8% as compared to \$134.9 million last year. And adjusting for the 53rd week of sales, sales increased 1.4%, compared to last year. Retail sales, same store sales decreased 0.8% in fiscal 2008 and decreased 0.2% in the fourth quarter 2008. In summary, we're very pleased with the strong sales results in fiscal 2008, compared to the prior year.

The following is a breakdown of EBITDA by business segment for fiscal 2008. Our food distribution segment EBITDA was \$109.6 million or 4% of sales in fiscal 2008, a 7.3% increase, as compared to \$102.2 million or 3.8% of sales in 2007. EBITDA in our military segment was \$51.2 million or 3.8% of sale in fiscal 2008, an increase of 16.2% versus \$44 million or 3.5% of sales last year. In our retail segment, EBITDA for fiscal 2008 was \$31.4 million or 5.2% of sales, up 13.9% as compared to \$27.5 million or 4.6% of sales in 2007. We are pleased with the solid EBITDA performance company-wide which was a record \$143.7 million or up 11.6% from the fiscal 2007 -- or for fiscal 2008 and was up 30 basis points to 3.1% of sales versus 2007.

I'd like to comment regarding the progress towards our long-term key financial targets identified in our strategic plan. As you'll recall, one of our key financial targets is to achieve an improvement in our total Company EBITDA margin to 4% of sales. Just as important, we've also targeted to achieve free cash flow returns on net assets of 10%, a 2% organic sales growth rate and to delever our balance sheet to a debt to EBITDA ratio of 2.5 to three times.

Since announcing these targets in November 2006, we've realized significant improvement 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 a full turn-and-a-half of EBITDA from 3.42 times to 1.92 times. Our free cash flow to net assets, excluding strategic projects, improved to 14% during the trailing four quarters. And finally, our organic revenue growth was a solid 3.1% for fiscal 2008.

Total debt decreased by \$42.6 million during the fourth quarter to \$275.7 million. At the end of the quarter we had \$109.1 million of debt outstanding, including \$15.5 million of outstanding letters of credit on our revolver and had \$190.9 million of availability under that facility. And our leverage ratio of total debt to EBITDA was 1.92% at the end of the fourth quarter, as mentioned previously.

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 April 3rd, 2009. This is our 330th consecutive quarterly dividend paid. Now I'll turn the call back to Alec.

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

Thank you, Bob. And I guess my first comment for the year and for the quarter is we're extremely pleased with the results on all fronts that we've made at Nash Finch during the last year, as well as the quarter. I think the most encouraging sign to me as the health of our overall Company, is the continued growth that we see virtually in all business segments. I think our people are executing extremely well in all areas of our business. So we really couldn't be more pleased with where we are today, particularly in light of the economic situation that we have around us. We think we're very well positioned in light of all of that.

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When we look at the overall Company, I think I talk a lot about growth. We've worked hard here at Nash Finch to renew the growth of our Company in all areas. And when you look at the Company today and you look at the fourth quarter, even setting aside the 53rd week, we saw the Company grow 5.3% in a very difficult period. 4.1% in food distribution and we all know it hasn't been that long ago that we were talking about sales declines in food distribution. And setting aside the 53rd week, that division itself grew 4.1%. They are adding new customers, our current customers continue to buy more from us and consolidating more of their purchases from outside suppliers to Nash Finch.

Our category management program in Lima continues to work and help them to grow their sales, so we could not be more pleased there.

Our military business, of course, has always been a star gem for us. We've talked about it a lot. We've talked about growing it. Obviously we now are. Setting aside the 53rd week to see a company such as our military business grow 9.6% in a given quarter in this economic climate, we've got to feel pretty good about that. So when we look at the overall Company, I measure growth, of course, as being one key indicator because companies that do not grow eventually die. And we look at Nash Finch and see today that we've got a good track record of growth and got a good pipeline of growth for the future.

Now when we look at EBITDA. Well, it is difficult to set aside the impact of the 53rd week because you get into that extra week and you've got some fixed expenses that always lapse over. But I always drive Bob crazy trying to make sure that he does that and gets me a number that I can understand. Because I -- I think that it's fair to say, wait a minute, the EBITDA for the year for the quarter looks great but we did have an extra week there that benefited that somewhat. But even setting aside that 53rd week, you see that we've improved EBITDA by 9.8% for the overall Company for the quarter.

13.3% in military alone because of the -- the good job the guys are doing out there in driving their efficiencies, the growth they're seeing on the top line and just doing a really good job of managing their business. Their damage is down. Their overtime expenses are down. Their accurate order index has gone up dramatically. So there's -- they are just doing all the right things out there.

In food distribution, we saw some start-up costs in our EBITDA performance there in the fourth quarter because we were still getting ready to open our new upstream facility in Bellefontaine. So we saw a little bit of that in our EBITDA numbers. Frankly, I don't know that this is any different from what you'll hear everywhere else but we had anticipated a little stronger selling season at Christmas than we saw. We saw the consumer pull back a little bit right at Christmas and that wasn't such a surprise given the state of economy.

But I guess the most important thing we saw was more of a beginning of some price declines in certain commodities that influenced our food distribution group and if you'll think back quarter over quarter over quarter, even going back, in fact I looked at the transcripts yesterday. I think in every single conference call during 2008, I explained that we were benefiting from a high and unprecedented inflationary period. Now that doesn't mean that when inflation tempers that we've got a bad business, because we did not build this business on the expectation of inflation. But when inflation is there, as I've said repeatedly, our people are going to do what they always do and that's the best job of making the proper investments to benefit our customers first and also benefit our gross margin line. And they did that during 2008.

But in the latter part of the fourth quarter, we began to see some changes in pricing, particularly as it related to commodities, specifically in dairy. We saw fluid milk, we saw eggs, we saw a number of items that began to decline so when that happens, of course we're going to see a bit of a -- of a drop in our gross margin for that period of time. But we monitor all of the aspects of our business. And in food distribution, we've got growth, we've got good execution. Our expenses are -- continue. Our efficiencies continue to improve and listen, we'll let inflation do what inflation does because it goes down, it goes up. I've been in this business a long time. I told you we wouldn't have that forever but we didn't build our business on the expectation of having that.

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When we look at the earnings per share, it's clearly heavily influenced once again, by LIFO. I think that as we get into 2009, I'll probably be talking less about LIFO from what we see right now because inflation is clearly cooled off. But listen, there was \$5.5 million in non-cash expenses in LIFO and of course, that is hard to overcome. But when you adjust for the significant items which was about \$0.25 or so a share, you see that we actually had an increase of 16% in EPS in the fourth quarter alone. And I think in this day and time, in this economy in this world we're in today, I don't know that there's too many companies that are talking about a 16% improvement in EPS for a given quarter. So we feel very strong and very pleased with those results.

As Bob mentioned in these particular times we have had a -- an internal mandate among ourselves, but also collectively with our Board to make sure that our balance sheet remains strong. Liquidity is king right now. Cash is king. Making sure that we have plenty of headroom. And that has been a fundamental objective of myself, of Bob, our management team and the Board from the very beginning of this economic downturn. And as you look at where we were at the end of the year, we only had leverage of 1.92, well below our targeted range of 2.5 to 3. But then when you look even immediately after the closing of the GSE acquisition which occurred after the conclusion of the fourth quarter, it actually occurred at the end of January. Even then, having just acquired a company, our ratio was only at 2.53, still on the low end of our targeted range of 2.5 to 3. So we have plenty of liquidity and we're very well positioned to continue our strategic initiatives and very well positioned to continue to encounter the difficult world around us.

As Bob mentioned, we take our targets very seriously. We now are exceeding our growth target of 2%, that's clear from the numbers. We are moving in the right direction on our EBITDA target because we want to get to 4%. We started at 2.2%, we're now over 3% so we've still got a distance to sprint there. And that will take some time. That last section of EBITDA always takes more time and effort than making the initial improvements, I think we all know that.

Our free cash flow target is something that we take very serious because we heard clearly from our investors when I first joined the Company that this was one of reasons why that they owned Nash Finch stock. Because a distribution business run properly should be able to deliver good solid returns on free cash flow to net assets and we committed that we would continue to do that. Last year we did a good job with that. This year we actually came in well above our target of 10%, we actually landed at 14%. That is an extraordinary return on net assets. I would ask our constituencies not to get used to that because we were -- we were aiming toward 10% and we were fighting high inflation and heavy inventories to get there and we landed at 14%. And principally, one of the key reasons for that happened to be the calendar, the way the military roll-ups occur every two weeks. All of a sudden, you can get an incredible influx of cash because of a roll-up of accounts receivable, that's just the way the military business is. And because of our 53rd week and the way that the calendar cut off, we had an incredible influx of cash there that drove that to 14%. But we feel very comfortable that our 10% target is right and that our 10% target is achievable and obviously with an achievement of 14%, that's pretty clear.

Our debt ratio, as I mentioned earlier, well ahead of our targeted range, even after the acquisition of GSE.

Now speaking of GSC and the acquisition of the three distribution centers in Pensacola, Florida, Junction City, Kansas and San Antonio, Texas, I'll give you a brief update there. The acquisition, what's completed, it was completed a little bit ahead of time from what we thought it would be. It was done very quickly at the end of our first period, which was at the end of January. And so we'll have two periods of GSC with us in the first quarter of 2009. We are extremely pleased to have all of these new associates as part of Nash Finch, they are a fine group of people and they are just doing a fabulous job.

We now have a combined integration team of management members that are made up of MDV team members and GSC team members, who are working fast and hard on very specific initiatives. Because well ahead of the acquisition, we had both sides of the equation with GSC and MDV clearly understanding what are the things that we need to get done quickly in order to make sure that this is an accretive and that this is a positive experience for both companies through this acquisition. And we're already seeing some of those things materialize.

We saw a substantial increase in fill rates to customer service by GSC because of changes that we've made and helped them with and they're just doing a fabulous job with those. We've been able to help them with some of their buying power on

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non-product merchandise. Just to give you one example, shrink wrap. We use a huge amount of shrink wrap in all of these distribution centers and we were able to reduce the cost to GSC by close to \$5 a roll. Only solely in shrink wrap, because of our buying power as a total company and the way that we procure shrink wrap. And there's a whole litany of those. It goes on and on and on that was part of the synergy list that we identified when we looked at GSC to begin with.

So things are going very well. There have been no surprises. That is always the most important thing. We haven't surprised them, they haven't surprised us. That's always a good thing. And sales, frankly, seems to be coming in just about where we expected. Maybe just a little bit better than where we expected. So I think we couldn't be more pleased with the acquisition of the three distribution centers and things -- it is very early, of course, but things seem to be going very well.

Now, as we look at the first quarter of 2009, as we look at where we're at, we believe that again, setting aside GSC because that's all additional volume, but setting aside the impact of GSC, we anticipate that sales will increase in our Company, company-wide, by about 2%. Now we've continued to add a lot of customers to the food distribution side, military continues to grow. But we all are aware that customers are trading down. There's more ingredient based shopping. And in our food distribution business, our private label sales, like every other retailer and wholesaler, is up substantially. Our private label grew over 10% in 2008 and we're already seeing it grow over 6% again in 2009. And that growth in 2009 is bucking the trend on some price decreases in dairy. If it wasn't for some of those price decreases it would even be up much higher than that.

So with all those things combined, we're seeing the continuation of additional customers being added to the food distribution side. But because of the change in mix, we don't quite get as big a jump on the top line as we otherwise would have because of some of those changes. But we expect that overall, company-wide, we would be able to come in, setting aside GSE, at just about 2% above prior year for the growth side of things.

Now when we get to looking at the retail side, from just our corporate retail stores. We all realize that as we've grown our military division and as we've grown our food distribution division, the retailer side is a less larger component of overall sales, but they're still a very important division. But we do expect contraction in sales within that division. We expect our comparable -- our comparable store sales to be negative by as much as 3% in the quarter and that's really driven by a variety of things that I don't think is -- is new news to anybody.

We do have a new Hispanic competitor in Denver which we're trying to cycle through right now. We're doing a really good job of managing against that new store opening and we're dedicated to protecting our market share. But we've got a period of time here that we've got to encounter that new store opening. And our Avanza stores, as you might remember, have been some of the highest growth stores that we've had. So they've been offsetting some of the other stores that have been under competitive pressures and so when Avanza gets a new competitor, it takes some of that away from us and we become a little bit less able to have strong comparable store sales, so that is one thing.

Deflation in certain food products, we're seeing it very clearly in our store sales. I mean, if you look at milk sales and egg sales, all of those major commodities are down substantially and when you look at fluid milk and you look at something like eggs, they are such a large percentage of what gets sold in supermarkets that it is hard to overcome that with other items. We're continuing to see a substantial trading down in generics in the pharmacy. And even though we like to sell generics in the pharmacy, the fact of matter is we're trading large dollars for small dollars on the sales line when we do that. And of course in our corporate stores, just like in our food distribution business, we're seeing a substantial growth in private label product sales products as well, which does a lot of good things from a growth margin perspective but it does have -- does put pressure on the top line because private label is anywhere from 18% to 25% cheaper than the national brand, overall.

We do expect gross margin to come under pressure, particularly in our food distribution segment in the first quarter. Again, I think if you go back to the first quarter call in 2008, we had an exceptionally high gross margin during that particular quarter. I said very clearly that that would not be able to continue. That that is in fact of inflation. Well, now we're seeing some deflation in commodity products, we're seeing a lack of inflation in non-commodity products. These are all business cycles, they are not permanent but when they occur, they have either a positive impact as they did temporarily in 2008 or they'll have a negative

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effect temporarily as we saw a little bit in the fourth quarter. And somewhat as we'll see in the first quarter of 2009 and then we'll expect that that impact will begin to -- to level out.

Because of that, excluding GSC, we expect EBITDA for the first quarter to come in lower than the first quarter of 2007. We continue to add new customers, our top line will continue to grow. All of our other lines will continue to be where they -- where they should be, and where they historically have been. There's absolutely nothing that has changed fundamentally about our business.

What we will see is a bit of a contraction in the gross margin line, particularly in food distribution because of a lack of inflation and also because we're comparing to the first quarter of 2008 where we had an enormous amount of inflation, at least in our inventories. Therefore, that's going to create a shortfall in the first quarter of EBITDA as we look and compare to the first quarter of 2008. Now specifically, GSC is expected to add as much as \$110 million in sales during the quarter, just from the first two periods. But I want to remind you, as I mentioned when we announced the acquisition of GSC, the EBITDA contribution on these sales do not compare at all to MDV.

Again, as we look several years out we believe that -- we're more convinced now than ever that we'll be able to achieve a 13% or greater return -- return rate on that investment. But it will take about 36 months or so to get that done. Therefore as -- in the early stages of bringing in sales of GSC, they simply won't contribute to the level that we expect that they will contribute 24, 36 months down the road and certainly, they will not contribute to the extend that MDV contributes on a pro rata sales business.

Now in light of all of the things I've talked about, I also want to make sure that it's understood that even though we are a company that's continuing to grow, even though we are a company that continues to perform, we still nonetheless feel that it has been appropriate for us internally to take some steps to mitigate some of these impacts and be ready to experience whatever the unexpected might have for us in 2009. So as a company, we have put in place a company-wide wage freeze. So all normal merit increases, we've alerted our associates, will not be granted at this time. We have a hiring freeze in place throughout the entire Company on all noncritical open salary positions. And we have a position review underway right now with HR that we expect to be concluded by the first quarter which will help identify where we might have non-critical positions that might be targets of elimination, so that we can make sure that we're pushing towards maximizing our efficiency.

And we have made decisions currently to delay some capital spending. Specifically we had planned to remodel two stores to our Family Fresh format in 2009. We have backed that down to one. We will continue to do New Richmond, which is under construction now and already we're seeing great sales increases from that remodel, even though the -- we've got the store tore up, the sales are already coming up. But we had planned to do one additional store in 2009. We will delay that store until 2010. And we've delayed some other capital that's required, further out as well.

So we've been able to go through that, we think take some prudent steps to make sure that we maximize our cash, make sure that we protect our liquidity, simply because of the uncertain environment that we find ourselves, everyone else finds themselves in in the business environment today.

In summary, I would say that we continue to be very pleased with the results of operation Fresh Start. It appears to be working. It is helping us to achieve our growth-related goals. We're extremely pleased with our Avanza stores, and we plan to continue to expand the format. As a matter of fact, we have one store that is under construction right now which will likely become, if our market surveys are anywhere close to accurate as they normally have been, it will likely become our highest volume Avanza store yet. And that is in the Aurora area of the Denver, Colorado area.

Family Fresh, the store that we launched in 2008 in Hudson, Wisconsin continues to perform extremely well from a sales perspective. And we're just getting excellent consumer ratings in all of our perishable departments. so that is -- it continues to progress.

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Our Center Store initiative that we launched in our Lima distribution center continues to post excellent results. It is helping us to grow our business, because we're adding customers as a result of it and it will soon be ready to be rolled out into some of our other facilities here in the not too distant future.

Our upstream warehouse which if you will recall, was one of the initiatives that we put in place, designed to help us reduce our operating costs. That facility opened shortly after the first of the year. We have now transitioned all customers from the Lima division to the upstream facility. And actually, this week we started transitioning some of the customers out of the Westville facility into this new warehouse. And things seem to be going extremely well. It is quite successful, at least so far. We've only been open now for a few weeks but boy, we're pleased with what we're seeing in that side of our business.

We are extremely pleased that our food distribution business continues to add customers at a very impressive pace and our pipeline today is a strong if not stronger than it has ever been, and so we feel very good about that. And our military business remains the gold standard of the industry and the addition of GSC obviously, will only make that stronger.

So all of us at Nash Finch fully recognize the difficult economic environment that we're operating in. But I think it's clear and obviously, from what I've talked about and the track record that we have, that our Company is well positioned to weather this storm and to take advantage of all of opportunities that come our way as a result of it.

So with that, Mark, I'm ready to take questions. If you could give me a hand with that, I would appreciate it.

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## QUESTIONS AND ANSWERS

### Operator

Yes, thank you very much. (Operator Instructions). Our first question today comes from Karen Howland with Barclays Capital.

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### Karen Howland - Barclays Capital - Analyst

Hi. Just a housekeeping, can -- did you give CapEx guidance for the first quarter and for fiscal year '09?

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### Alec Covington - Nash Finch Company - President, CEO, Director

I didn't. And I don't have that number right off the top of my head. I know we -- do you know, Bob, or do we need to get back to her?

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### Bob Dimond - Nash Finch Company - EVP, CFO and Treasurer

I've got the number. We had originally targeted right between \$55 million and \$60 million for the year.

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### Alec Covington - Nash Finch Company - President, CEO, Director

Year-over-year.

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**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

Right. For the quarter we -- we really don't have that broken down for you but for the year \$55 million to \$60 million. And then as Alec mentioned, we have earmarked some reductions from that that probably pull \$8 million or \$10 million off of that.

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

Right.

**Karen Howland** - *Barclays Capital - Analyst*

Okay. So thank you, so probably more the \$45 million to -- \$45 million to \$50 million range?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

Yes.

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

Correct.

**Karen Howland** - *Barclays Capital - Analyst*

Okay and -- and then I know you didn't -- you talked a little bit about how the acquisition had a lower margin than the current military. Just as far as that trying to help us model it out, can you -- I mean, is it -- are we talking a 1% EBITDA margin? Is it -- is it higher than that? Where do you think the opportunity -- can it get up to the level of the military margin in that 3.5% to 4% area?

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

Well, I -- I would say this and Bob may have some comments on that as well. It will -- we -- we were attracted to GSC because we believe that the business was -- it could potentially perform much better than it was performing. So that's on one end of the scale. On the other end of the scale is MDV sitting there at 4% or wherever they are right now. I don't have the number right in front of me. It was probably closer to 4%. We'll never get to 4% and the reason is because on average MDV travels about 200 to 250 miles to make deliveries and GSC travels today roughly three times that much. We think we can reduce that quite a bit over the next year or so.

So we're always going to be plagued with much higher transportation expense because they go much further to reach the destination basis than we do at MDV simply because of the the geography. They are going to bases in New Mexico and obviously, we know Texas is not a small state, so you've got enormous travel there. So we believe that it can be dramatically improved and I guess what we stated in the past is that today GSC is on the low end of -- of that range. We've never given a specific range there. Obviously you see MDV on the -- on the high end. We believe we'll move it more towards the middle. But the one thing that we are -- are certain of is that with the way that we acquired GSC, we're very comfortable that we can deliver at least a 13% internal rate of return on the investment that we made of \$80 million or so in that business.

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**Karen Howland** - Barclays Capital - Analyst

Okay. And then if I think about -- I know during the last conference call we kind of talked a little bit about deflation and how you thought it would play out and my understanding that you said that you often get support from some of the manufacturers as far as floor stock protection when you -- when it does become a deflationary environment. Do you expect that to happen? And is it just that the margin will continue to get squeezed above and beyond that?

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

Yes. As we -- as we look at -- at what's happening out there, Karen, I mean I -- I don't worry about having any major devaluation of our inventories because of deflation, just from a -- from the practicality of it. We're not seeing manufacturers dramatically lowering their prices and -- and I happen to be in the camp that doesn't expect to see a lot of that on processed and prepared food items. What we are seeing and what we have seen has really been on the commodities side and those are areas where there's not much you can do. When you look at commodities such as eggs, cheese, those are things that you don't get floor stock protection on because they're sheer commodities. And when they take a drop on you, you just have to take it on the chin. You make it on the way up and take it on the -- on the chin on the way down and it is not just in grocery. We're seeing if you look at some of the -- some of the meat items today, you are seeing some of it there, you are seeing some in produce so it's -- it's kind of all over the board. But it is more the commodity impact that we have felt here recently than anything else.

**Karen Howland** - Barclays Capital - Analyst

And is it safe to say the commodities -- because of the -- of -- hence the name, the commodity nature of them, people are a little bit more sensitive to the pricing than they were perhaps of the packaged goods. They -- and so they -- the lower prices have to be immediately reflected in the prices that you then charge the retailers and the retailers then charge the consumer. Whereas on the packaged goods, I'm not saying that you are seeing deflation but if there was to be some deflation, it could be a little bit stickier?

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

Absolutely. When you look at -- at buying sheer commodities such as grains or -- or whether it is dairy products or whatever it might be, manufacturers or providers, they go up when the market goes up, they go down when the market goes down and there's really not much of a time lag between those two. But when you look at for the processed items, there's not as strong a correlation between commodity decreases and increases as maybe you would think in terms of prices that go up and prices that go down. And we're not seeing at this time a major shift, a downward pricing spiral in any kind of prepared food items or -- or anything like that. We simply saw some deflation, particularly in dairy, in some commodity items.

**Karen Howland** - Barclays Capital - Analyst

And is it safe to assume, because I think you actually saw a benefit for at least the first two quarters of this year, because of the inflation -- inflationary environment, that the EBITDA, in particular in distribution, would actually be down not just in the first quarter but in the second quarter as well?

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

It -- it's hard to say, Karen, because as we look at our inventories right now this moment, we know that we're -- we're not seeing price increases. It's not so much -- we've got a little bit of impact in the -- a little bit in the fourth quarter, and -- and we're seeing a little bit of it in -- in -- into the first quarter of declines in some commodities, as I mentioned, particularly dairy. But what --

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we're -- we're not seeing deflation as being the issue, it's more of a lack of inflation that is more of the issue. If you look at our inventories today, we're still seeing a -- a flow of some price -- pricing gains but it's not nearly to the level that it was a year ago.

And then we have the issue of needing to cycle through that inventory. So as an example you could have some actual price gains in your inventory, but it might right now be overshadowed by cheese products or eggs or something else that currently has gone down. Once you cycle through that inventory of those products that have actually declined, now your embedded price increases and gains actually show up again. So it's a little bit unclear for me to know exactly how long that's going to take.

I think what we're seeing and maybe what we have seen is a little bit of an aberration. And frankly, Karen, it was brought about by the fact that we maximized that opportunity a year ago. I mean, if you -- if you drew a line from where we started in 2006 to where we're going to end up here at the end of the first quarter or anywhere you want to draw the line, you would be very pleased in terms of the improvement of gross margins from the beginning to the end. But in the middle, we created some usual jumps and spikes because we believed the right thing to do was to make hay when the sun was shining and invest properly in inventories and take those gains, knowing full well that when that party was over, we would see at least a temporary contraction in some of our gross margins and consequently, our EBITDA in some select areas of our business. But if you look at our fundamentals, that is the only line in our P&L that we see any shifts in whatsoever and it is really just the one line that we really can't control that much.

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**Karen Howland** - *Barclays Capital - Analyst*

Right. And you said that you are seeing an increase in private label, presumably retail as well as distribution and that's higher margin in both businesses as well, right?

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

It is.

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**Karen Howland** - *Barclays Capital - Analyst*

Okay. So it -- it's just not enough on the distribution to make up for the significant benefit you saw in the first quarter last year?

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

No. We just saw some unusual spikes. And -- and I think even in the first quarter last year, I think in my comments on the first quarter right out of the gate, I said, listen we had a great quarter, but even I wouldn't have predicted a quarter that was as good. And it was -- and it was just simply driven by some really strong spikes in pricing and -- and then we were sitting on some pretty heavy inventories at that time.

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**Karen Howland** - *Barclays Capital - Analyst*

Right. And then I was wondering if you -- looking at just a -- just as far as the macro environment, if you think about your -- you obviously provide distribution to a wide array of different -- different quality of stores. Are you seeing trading down amongst the store base or -- or some of lower -- lower income stores doing better, or can you talk about the trends you're seeing there?

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

I would say just thinking about our own corporate store group and others that I talk to, there's some universal trends because we have a full gamut even in our corporate environment. We've got stores in difficult economic areas and have the Family Fresh store over here in Hudson, Wisconsin is really more of a middle to upper income area. But the trends are somewhat the same everywhere.

And I'll give you some examples of that. We're seeing discretionary buying such as citrus products in produce, that's off. But then basic ingredient items such as tomatoes which are much cheaper now coming out of Mexico, tomato sales are up. If we look at meat, our meat sales overall, if you look at the tonnage we're shipping is actually up. But because of the shift of what we're selling, the dollars are actually under pressure. And the reason for that is we're seeing such a spike, an increase, I think our ground beef sales are up something like 16.5%. But when you look at where that's coming from, well it's people shifting off of higher-priced pork cuts and other items, shifting more towards ground beef. We're actually selling -- if -- if you can imagine it, we're actually selling more steaks right now than we were, but the price is way down. And the price is way down because the restaurant industry usually buys all of those middle meats and creates a higher price at store level. And the restaurant business is off so much that we're buying -- we're buying steaks at unprecedented prices and we're actually selling some, but the dollar rating is not nearly what it was a year ago.

And so it's really a shift in those areas, a dramatic shift away from typical proteins, whether it is -- a poultry and pork towards grinds. Then when you look at the -- the grocery department, we're seeing a decline in prepared food items. So if you look up and down the grocery isles, we're seeing that shoppers today look like shoppers, frankly, early on when I joined this business which is that they are buying more basic items. They are buying flour and they are buying ingredient-based -- they are more ingredient-based shoppers, Karen, where a year ago they were buying prepared dinners, things that you could stick in the microwave. We're seeing that same trend in the frozen food aisle and in the dairy aisle. When you get to the pharmacy, we're seeing a really strong shift to generics and we're concerned that some of our customers, who historically were getting prescriptions filled may not have the money to get them filled today. And so we worry about that. And so we're seeing those kinds of trends throughout the supermarket and as I talk to our large customers at various food shows, I'm getting the same feeling from them and the underlining trends that I've been looking at in the last few weeks in our food distribution business is also consistent with what I've just described.

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**Karen Howland** - Barclays Capital - Analyst

Okay, great. Thank you very much for the additional color.

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

Sure. Mark, are there any other questions?

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**Operator**

We have one question at this time. (Operator Instructions). And now we'll take Blaine Marder with Loeb Partners.

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**Blaine Marder** - Loeb Partners - Analyst

Hey, Alec, how are you?

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

Good, Blaine, how are you?

**Blaine Marder** - Loeb Partners - Analyst

Good. Congratulations on your success with this company. We all appreciate it as shareholders. And let's go back to the organic outlook for '09. Let's set aside puts and takes of the economy, food deflation and the trading down aspect. And I guess the question is, is the underlying trajectory of this company, both in revenue and EBITDA still up? And what I mean by that is, of course you are going to say yes, but you've been at this company for a while now. Have the gains sort of slowed down such that we need acquisitions like GSC to sort of regain the organic underlying core momentum?

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

No. Blaine, on the -- frankly the only -- the only challenge that we're going to deal with here over the next few months is one little line. But boy, it has huge impacts on P&L and that's that investment buying that we do in inflationary inventories. But if you look at our -- the cases we're shipping in our distribution centers, the customers that we're adding. Frankly, we just signed up another customer here that we've just begun shipping, that was another \$20 million from a national retailer that we -- we just became affiliated with. The pipeline is as big right now as it -- as it has been. Our losses of customers has come down to -- the only losses we really see these days is where somebody goes out of business, or they lose a lease or something like that.

So in the food distribution business, our top line used to be our number one worry. It is not our number one worry at all in that, that business right now. It's growing quite rapidly.

Our military business has gained a lot by adding new vendors. Frankly with the addition of GSC listening carefully to what I hear from manufacturers, there is even more discussion around adding new lines to the overall network because the overall in the work is now larger and that's not just GSC, but that's also impacting or potentially will impact MDV. So there's not anything on the topline side at all that's giving us any kinds of concerns and the trajectory of the overall basic business key metrics that we're looking at today is today, the best that it's been since I joined the Company.

**Blaine Marder** - Loeb Partners - Analyst

Okay. And now do you see GSC adding a lot of CapEx? If you try and fix the transportation problem, are you going to start adding DC's to sort of -- to sort of mitigate that problem which will throw the CapEx up a little bit?

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

We have -- I think in -- in 2009, Bob, there's probably \$3.5 million that we've allocated for GSC. Frankly we had added the \$3.5 million on top of what was at that time close to \$60 million in our CapEx budget. When we went back and did our revisions, we've now included their \$3.5 million into our normal maintenance CapEx. And we've whacked \$8 million to \$10 million on top of that and so GSC's maintenance capital for 2009 is embedded now in our normal maintenance CapEx.

**Blaine Marder** - Loeb Partners - Analyst

Right.

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

And we had planned for all of those items as we did the acquisition. Now in outlying years, it will benefit us to add some distribution points to reduce those miles and we actually as part of the model we built, we assumed that we would do that. But we will do that more through looking at lease facilities that will minimize the CapEx that we need to do that. Bull we factored that in as we did the acquisition into our returns. So it would be smart of us, as soon as we are confident, the sooner we could -- we could do those initiatives, the quicker we're going to get a payback. The other thing that that will do for us from what we know, is that it not only helps us to reduce some redundant miles, but it also allows us to add some additional business that we know is available to us when we could -- when we could add some additional capacity to link our -- the markets between the GSC territory and the existing MDV territory.

**Blaine Marder** - Loeb Partners - Analyst

Okay. And in knowing what you know right now in terms of trading down in food deflation, do you think you can gut out sort of a -- just hold on the EBITDA line in such a terrible year and just sort of hold in '09 and then -- and then look to grow in the following year? And there's nothing wrong with that, I'm looking at Cysco's estimates and it looks like they're going to be flat to down in '09 and flat in 2010, at least those are what the estimates say on EBITDA for Cysco, so you have company.

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

Blaine, I wish I had a solid answer for you on that right now. I've tried to examine clearly the first quarter and because we made so many investment buys in the first quarter of 2008, I'm left with no assessment except to believe that we're going to actually go down somewhat in EBITDA margin in the first quarter, setting aside GSE of course, we'll see some contraction.

What -- what I need, I think, is a little bit more time to get through the first quarter and see how our inventory cycles to be able to predict how it is going to look more in the second half, because my gut instinct says that we'll see the -- as we cycle through our inventories and change our mix, we'll see some of that impact dissipate. But I'm cautious. As you know, one of the things that we have done in this Company is we've never surprised guys like you and we have always underpromised and overdelivered. And so I take your questions very, very serious and right now I know that I'm left with the opinion that we're going to see some contraction in the first quarter and I need a little bit more time to get too much further out with that to know exactly how that's going to translate into the full year.

**Blaine Marder** - Loeb Partners - Analyst

Okay. Fair enough and then let's move on to cash flow and -- and I have a question more technical for Bob on the debt. Now, what are you thinking in terms of uses of cash flow, we know what your CapEx is. But I'm looking at 2008 or 2009 fiscal year and you generated like \$80 million of free cash flow, okay? Your market cap is about \$350 million so that is just an astounding feat. And I'm wondering up and above CapEx, what are you looking to do? We know you've got the cash acquisition, and you've got the dividend. But above that, I mean, what is the strategic thoughts at your level and at the Board level?

**Bob Dimond** - Nash Finch Company - EVP, CFO and Treasurer

Yes. If -- if you were to set aside the acquisition for just a moment, we -- it -- even with the CapEx that we had mentioned, the -- the \$45 million to \$50 millionish, we -- we would still have planned to -- to see some net free cash flow after the payment of that to the tune of \$20 million or \$30 million.

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**Blaine Marder** - *Loeb Partners - Analyst*

\$20 million or \$30 million on top of the acquisition?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

And then when you factor in the acquisition, certainly we paid about \$80 million. We did get an extra \$40 million from our banking facility to be able to fund that, but I think even with that then factored in, we'll be just slightly ahead in debt of where we ended up this past year.

**Blaine Marder** - *Loeb Partners - Analyst*

Okay.

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

If that holds out.

**Blaine Marder** - *Loeb Partners - Analyst*

Now you are using the senior secured facility, is that correct?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

That's correct.

**Blaine Marder** - *Loeb Partners - Analyst*

So you are putting a little there. But you have no maturities -- I mean you've got this senior -- the convertible debt does not put for a couple years and when is the revolver and the senior secured facility, when does that come due?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

We actually have four years left on the revolver and 2013 is when the bonds come due, so we don't have any maturities or mandatory repayments coming up in the near future.

**Blaine Marder** - *Loeb Partners - Analyst*

Okay. And then just lastly, Bob, for you, can you address on the cash flow statement. One, the high level of inventories is that the extra week and two, the loans to customers which sort of ballooned out this year?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

Sure. On the inventory side, that is not so much the extra week, but that has more to do with the inflation in inventories that we had seen this -- from 2007 to 2008. And as far as the loans, yes, that did go up by about, what is that? That ended up going up a little under \$20 million, and that is -- we had some opportunities during the year to assist some of our better customers,

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and actually we helped one that we announced a little bit earlier in the year to actually do a buyout, a management buyout, and we've helped them along that way.

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

There's been some, we -- we've been -- we've taken obviously a very strict view on any type of commitments. As you've noticed our bad debt writedown has been virtually nil since we wiped out that whole Carter's thing and all of that. And so I think we've got a pretty good formula for evaluating those and as you look at the increase in those loans, I would say that those were -- those were once in a lifetime opportunities that really came about for some of our retailers as a result of the bad banking environment that was around and the tough economic times and those are high performing entities that we got involved in there which I think will pay big dividends and also secure

**Blaine Marder** - *Loeb Partners - Analyst*

Good, good. Thanks, Alec, thanks, Bob, take care.

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

Mark, do we have anything else?

**Operator**

We have one question at this time. (Operator Instructions). And next we'll hear from Mason Stark with Ramius Capital.

**Mason Stark** - *Ramius Capital - Analyst*

Hi, good morning, gentlemen.

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

Hi.

**Mason Stark** - *Ramius Capital - Analyst*

Sorry. Most of the questions got asked already so just a couple of quick ones. In the previous call, I missed the GSC call that you had. You mentioned that you were going to have negative goodwill and if I recall, FASB 141. Usually you would recognize a gain on that negative goodwill and probably (inaudible) in Q1, is that correct? And if so, could you give us an estimate of what that would be?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

First of all, you are correct that -- as we report our first quarter we will reflect whatever that gain is. We are still in the process of having our -- the appraisal done on that, so I do not have an estimate for you yet, Mason. But we did -- we had the opportunity to purchase these GSC assets at a very -- very good rate. And as a result, once we add on kind of the hard assets to that, it will end up generating negative goodwill which we'll have to flip into income.

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**Mason Stark** - *Ramius Capital - Analyst*

Okay. And could you just give a -- a quick discussion as to what was sort of the state of the seller, in this case? I mean were they distressed? Why were you able to buy this at a rate below tangible book?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

Yes. The -- no, I wouldn't say at all that they were under any kind of real stress. I think the issue was, Mason, that they had counted on when they built the new facility in Junction City, Kansas, they had anticipated through that, that they would grow dramatically in what we call the front range area of the military side which is Colorado and parts of the Midwest. And it was just coincidental, I didn't even know these people but it was only coincidental that we made a decision back when I first joined the Company to extend our military reach and our Omaha, Nebraska facility which is only 100 miles from that one. And we gained roughly \$160 million or so in volume and they gained very little.

And so we got to know each another out of coincidental strategies that we just didn't realize one was working on one piece and the other was working on something else. So they looked at that and questioned how far they would be able to grow beyond where they were with military and were they better off to try to grow it on their own or better off to look into consolidation? But, the whole relationship was born from, actually just a blind phone call I made to the Chairman of the Board to introduce myself and ask for the opportunity to talk to him.

And then over the next several months, I think they realized that we had a pretty strong platform in military, and they also looked at it, perhaps, as an opportunity to really focus on their core business which is the the convenience store business and the financial services business that they have, which is a very good business based in Sulfur Springs. And so it gave them an opportunity to retrench back into a core business and get out of a business that, because of our expansion, was becoming very competitive for them.

**Mason Stark** - *Ramius Capital - Analyst*

Okay, okay. Interesting. Last question, then. Just a -- this is just a technical question on the convert, I believe APB 14-1 is going into effect and that -- if I understand it correctly, you may -- your convert may be changed in terms of the way they look at it into more of a bond instrument. And that it would be done retroactively applied in '09. Is that the case? And if so, do you care to comment about how that would affect both your balance and income statement?

**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

Yes. In fact, ours is one of the converts that gets affected there and what you'll see here starting in our first quarter results, you'll see that we will reclass a small portion of the debt down in -- as equity, as the APB 14-A requires. And on a -- an income statement perspective, it will also cause us to begin realizing some non-cash interest expense this year going forward until the settlement date. And you'll see a retroactive adjustment for that, which will adjust the prior years, comparative years in the income statement, as well as going forward, a little higher interest dollar.

**Mason Stark** - *Ramius Capital - Analyst*

Got you. Okay. Thanks.

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**Bob Dimond** - *Nash Finch Company - EVP, CFO and Treasurer*

All non-cash.

**Mason Stark** - *Ramius Capital - Analyst*

Got you. I understand. Have a good -- have a good year.

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

All right. Thank you very much, Mason.

**Mason Stark** - *Ramius Capital - Analyst*

Take care.

**Operator**

Mark, is there anyone else we need to talk to? We have no questions at this time. And I'll turn the conference back over to Mr. Covington for any closing or additional remarks.

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

All right. Well, listen, we really appreciate everyone's participation and we look forward to talking to you at the end of the first quarter. Thank you very much.

**Operator**

And that does conclude our conference call. Thank you for joining us today.

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