

DIAMOND FOODS, INC.
FISCAL Q2 2007 EARNINGS CONFERENCE CALL

March 8, 2007, 1:30 PM PT

Chairperson: Bob Philipps, VP Treasury & Investor Relations

Bob Philipps:

Thank you operator and good afternoon everyone. Welcome to the Diamond Foods conference call and webcast to review the financial results of our fiscal second quarter 2007, which ended January 31. Let me review several housekeeping items before we get started.

- First, a printed copy of our prepared remarks is currently available on our website www.diamondfoods.com under the section titled "Investor Relations" followed by "Earnings Releases".
- Second, we've arranged for a taped replay of this call which may be accessed by telephone. This replay will take effect approximately one hour after the call's conclusion, and will remain available until midnight Pacific Time on March 15th, 2007. The dial-in number to access the replay is 1-800-405-2236, or for international callers, 303-590-3000. The pass code required to access the call, regardless of the number you have dialed, is 11084415#. In addition, this call is being webcast live with a replay also available on our website.
- Third, I want to remind you that during the course of this call we will make projections, or forward-looking statements, that are subject to many risks and uncertainties that could cause actual results to differ materially from expectations. A detailed discussion of the risks and uncertainties that affect our business is contained in our SEC filings under the heading "Risk Factors".

Our projections and forward-looking statements are based on factors that are subject to change, and therefore these statements speak only as of the date they are given. We do not undertake to update projections or forward-looking statements.

- Now I'd like to turn the call over to Michael Mendes, President and Chief Executive Officer of Diamond Foods.

Michael Mendes:

Good afternoon everyone and thank you for joining us. Participating with me in today's call will be Gary Ford, our Chief Operating Officer and Seth Halio, our Chief Financial Officer. I would also like to welcome Bob Philipps, who opened the call. Bob recently joined the Diamond organization as Vice President of Investor Relations.

Today we announced our second quarter earnings and our performance demonstrates that we're on the right track to achieve our fiscal year goals.

- For the second quarter, North American retail sales grew 28 percent, bringing the fiscal year-to-date growth rate to 14 percent.
- Our retail growth was driven by a strong quarter for the snack category. Snack sales increased 150 percent to over 21 million dollars, due in large part to the investments we have been making in our brands. Driven by our Super Bowl promotion, our snack business for the food segment grew 68 percent for the 4-weeks ended January 28. This momentum has continued during the most recent 4-weeks. The data released today reflects February retail sales are up nearly 40 percent and we have gained share in every region of the country.

This growth reflects our relentless focus on execution – filling points of distribution, getting incremental floor displays, and applying some of what we have learned as a result of our experiences in the category since the introduction of Emerald less than 3-years ago. We were pleased with the success of the Emerald Bowl which drew a record audience, and even exceeded the television ratings of the Cotton Bowl. As part of the events leading up to the game, we launched a line of bold-flavored oven roasted peanuts. While these items have not yet contributed much to the topline, we have received a very favorable response from retailers who thought the bold flavors added energy and excitement to the peanut segment of the snack nut category.

- As we look ahead, we are increasingly confident that we'll achieve the 80 million dollar snack sales goal for the fiscal year. Our marketing focus during the first two years of Emerald's existence was designed to build brand awareness. Through effective advertising, as well as promotions associated with major events – such as the Super Bowl and the Olympics – we have made great progress in establishing name recognition in a short period of time. We have augmented our consumer support campaign with healthy lifestyle events such as the marathons in New York, Chicago, and Los Angeles, which enable us to reinforce Emerald as a source of “natural energy” in a context that resonates with consumers. As a result of this strategy, Emerald's total brand awareness is now 85% and distribution in U.S. food stores has reached 83%.
- This year, we took the next step in Emerald's development by creating a new campaign that works to further articulate the brands position. The central message for the 2007 campaign is: “Emerald nuts are an excellent source of natural energy during the time of the day when people need it most.” The feature element of the campaign is a commercial that first aired during the Super Bowl to an estimated audience of 140 million viewers.

So far, the reaction to the new campaign has been fantastic! Advertising Age ad critic Bob Garfield selected the Emerald spot as the top commercial during the Super Bowl, and awarded it his highest rating of 4-stars. Emerald was the only recipient to earn this rating. The website YouTube reported over 1.1 million viewings of the commercial. Our

integrated cable network and online campaign, which will run through May, is expected to generate over 600 million total impressions.

We continue to demonstrate our commitment to invest in building a brand that has broad consumer appeal and to effectively leverage our national supply chain system. By successfully executing this strategy, it will provide us with a strong position in a business where small regional competitors represent more than a third of the total category.

- Finally, as illustrated by the rapid introduction of our new bold-flavored peanuts, we are capable of taking innovative, exciting new products from the concept stage to the marketplace in a very short period of time, and will continue to do this in the future.
- It is important to remember that the investments we are making in our snack business are significant, and margins, so far, have been minimal. So, in order to derive sustained financial returns from this business, we are working hard to rapidly gain scale. Over the next few quarters, we'll continue to invest in advertising, promotion, and expanded distribution, to help build a strong foundation for future growth.

Now I'd like to turn the call over to Gary Ford.

Gary Ford:

Thanks Michael. Today I would like to focus my comments on two areas. First, I want to provide a status update on our efforts to promote snacks during the quarter and obtain new distribution. Second, I want to address some of the things we're doing to manage cost.

- First, as we mentioned during last quarter's call, we shipped nearly 15,000 displays to the market in the weeks leading up to the Super Bowl to drive additional impulse purchases, to gain secondary placement of product, and to reduce out-of-stocks. We also executed the co-promotion with Budweiser much more effectively this year than last.

In the mass merchandiser channel, we are optimistic the special promotions run during the quarter will translate into expanding permanent distribution in that channel, and the opportunity for more frequent promotional events.

With respect to the club channel, we currently do not have meaningful snack distribution. However, we are making progress, and we are confident that we'll see some authorizations within the next few quarters. As demonstrated by the success of our Diamond culinary and in-shell business over the last 10-years, we have long and deep relationships in this channel. We are confident that we'll replicate that success with the Emerald brand as well.

- Second, let me talk about managing cost. In order to improve margins, we lowered labor cost and improved quality by integrating processing and packaging equipment in our Stockton facility. This direct-feed system is the first of several productivity projects planned over the next 12 months to lower cost, improve yields and take quality to the next level. For example, we are in the planning stages of a new oven roasting system in the Indiana facility.

This project will add capacity and lower cost by producing products closer to the source and our Midwest and East coast markets.

- On a closing note, we've had a number of questions about the effect of the extended cold weather during January in California's Central Valley. As you all know, the weather created huge problems for citrus growers. In the case of walnuts, however, the cold weather was actually good, because walnut trees need chilling hours to stimulate uniform bud break and good leafing patterns. The weather so far this year has been ideal for the trees, and the industry is optimistic about the size of the 2007 crop.

Now I'd like to turn the call over to Seth Halio.

Seth Halio:

Thanks Gary and good afternoon everyone. Since many of our financial results were included in today's press release, I'll review some highlights, and then close with our fiscal 2007 outlook.

- In the second quarter, our revenue by product line was as follows: culinary sales were 62 million dollars, snack sales were 21 million dollars and in-shell sales were 18 million dollars, for total North American Retail sales of 101 million dollars.

Our North American Retail sales for the quarter grew 28 percent; leading this growth was the snack business, which was up 150 percent.

- The in-shell business, which, as you may recall, posted a year-over-year decline during the first quarter due to the late harvest, rebounded with a 40 percent increase, and is up 3 percent year-to-date. Our culinary business posted a solid increase of 8 percent.
- All of our retail product lines posted growth, both during the quarter and year-to-date, and as we said during the last call, we expect the impact from the late harvest to be minimal for the year.

Looking at our North American Retail sales by channel for the quarter, sales to grocery and drug stores were 56 percent of the mix, club was 30 percent, and mass merchandisers were 13 percent. Compared to last year's quarter, there was a 300 basis point shift from grocery & drug to club.

Ingredient and international sales totaled 42 million dollars, down 6 percent from last year. This is consistent with our strategy to focus this segment on value-added, higher margin products.

Total sales for the quarter were 144 million dollars, 16 percent above last year, bringing our growth for the year to 4 percent.

- Our gross margin for the quarter was 14.2 percent compared to 15 percent for the second quarter last year. This reflects introductory costs for new snack products, and

promotional activities and capacity expansion for all snack products. Additionally, we experienced incremental culinary sales growth in lower margin channels.

- SG&A expense for the quarter was 11.5 million dollars, consistent with the last two fiscal quarters. Compared to last year's levels, we had higher Sales and Marketing costs, including staffing.
- Advertising expense for the quarter was 5 million dollars compared to 4 million dollars last year; much of this increase reflects our new Emerald "natural energy" campaign. We expect to spend 11 to 12 million dollars in the second half of fiscal 2007 on advertising.
- Subsequent to the end of the quarter, we received notice that the I.R.S. approved the termination of our administrative pension plan. As we've discussed in the past, because the plan is fully funded, we expect to record a 6 million dollar non-cash charge during the third quarter. This offsets the 3 million dollar gain we recorded at the time of curtailment in the first quarter, so that on a full-year basis, we expect the net impact to be a one-time, non-cash charge of 3 million dollars.
- Non-GAAP EPS for the quarter was twelve cents per share, compared to last year's twenty cents. This decline is reflective of our investment in snacks, including slotting, promotion, capacity, advertising, selling and other expenses.
- Cash on hand at the end of the quarter was 25 million dollars and we had no short-term debt. On a year-to-date basis, cash used in operations was 9 million dollars; but consistent with the seasonality of our business, we generated about 18 million dollars in cash from operations during the second quarter.
- Year-to-date capital spending was 4.3 million dollars, and we paid a three cent per share dividend on February 5.
- Our outlook for full-year fiscal 2007 remains unchanged. We are on track to generate North American Retail sales growth of approximately 15 percent, and grow snack sales nearly 100 percent to 80 million dollars.
- We expect overall sales growth of between 5 and 8 percent, and gross margins of approximately 15 percent. Advertising expense for the year should be modestly higher than last year.
- Stock-based compensation expense is expected to be between 19 and 21 cents per share. Our effective tax rate is estimated to be 42 percent.
- As a result, we expect GAAP EPS of between 41 and 46 cents per share and non-GAAP EPS of between 50 and 55 cents per share.

With that, I'd like to turn the call back to Michael.

Michael Mendes:

Thanks Seth.

One of the things that gets me excited about our future, is the progress we've made during the last 18 months, particularly in attracting exceptional sales and marketing talent to the organization. As we grow, the quality of our people and their passion to succeed in an organization that is results-oriented and embraces an entrepreneurial spirit, will be critical to our success.

In summary, our culinary business is strong and growing, and continues contribute to our corporate profitability. Our snack business is growing rapidly, and we are achieving scale that will enable a platform for greater success in the future. With a strong balance sheet and virtually no debt, we are in a good position to continue to work towards achieving our long-term growth and profit objectives.

At this time, I'd like to open the call for questions.

*** END OF PREPARED REMARKS ***