

DIAMOND FOODS, INC.
Fiscal 2008 First Quarter Earnings Release Conference Call Q&A
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1:30 pm PT

Operator: Your first question comes from the line of Diane Geissler with Merrill Lynch.

Diane Geissler: Hi, good afternoon.

Michael Mendes: Hi, Diane.

Diane Geissler: Congratulations on your quarter!

Michael Mendes: Thank you very much.

Diane Geissler: Can I just ask, obviously you exceeded your stated goal of \$0.42 to \$0.48, but you are keeping your full year range at \$0.80 to \$0.90. Is that conservatism? Is it there is something in the back half of the year that we should be considering? Is there a timing shift into the front half, or something else that we should be considering as to why you haven't increased your annual guidance on the EPS line?

Michael Mendes: Diane, this is Michael. Obviously we are very early in the year, and we have some visibility into the top line. We feel we can move it up a bit from our earlier numbers, but we think that it is prudent, that given the input cost environment that we have been in, to be a bit cautious on adjusting our EPS at this point in time. But we feel that the environment continues to support our long-term, our annual guidance that we have already provided, but at this point in time, we think it is prudent to maintain our current guidance.

Diane Geissler: Okay, but there is nothing specific that you had anticipated happening in the second half of the year that has happened in the first half of the year, that would have caused that, like a timing shift?

Michael Mendes: No, not really, Diane. I think it is just a matter of a very small increase in top line that we have adjusted, and we felt that at this point, being so early in the year, that would be prudent to just maintain our guidance for the year.

Diane Geissler: Okay, I realize that, but for you, small top line moves have an impact on your bottom line, like a \$5 million move at your average growth margin of \$0.03 a share, so just trying to ascertain what the message is?

Michael Mendes: Yes, to answer your question, it's not a reflection of anything, of any change about the first half or the second half of the year.

Diane Geissler: Okay. All right. And then just had a question, your snack line was light versus what I had been looking for. Could you help us - you are guiding 50 to 65% revenue growth in snack. If you could give us some indication about, is there a timing shift to a big third quarter? What is your expectation about the kind of the quarterly ramp as we move through the rest of the year?

Michael Mendes: You know, just speaking broadly about our snack business, we had anticipated before we entered this year, that the first half of this year would not be as strong as the second half, and that we also anticipated that in the first half of the year, we would have a higher occurrence of slotting and entry costs, which as you know, are not only pure expenses, they are contra-revenue. We did expect that the second half would be a stronger sales growth than the first half, I would say that we still think that to be the case today.

Diane Geissler: Okay. Would you look for the second quarter to have a similar revenue trajectory in terms of percentages?

Michael Mendes: Yes, I would say that.

Diane Geissler: Year-over-year?

Michael Mendes: I would say we are not guiding on a quarterly basis. I think that direction of the first half, I think that would be a reasonable assessment. Again, I think that we will see most of our distribution gains realized, in terms of dollar sales in the second half of the year, in the final two quarters. So I think you could deduce that.

Diane Geissler: Okay, all right. Then just one question about your unit production costs. You had mentioned that in snack they were 15% lower. Did that include the not costs as well, so total all-in costs on the snack nut line, or was that kind of everything excluding the raw material?

Seth Halio: That excludes commodity costs, Diane.

Diane Geissler: Excludes commodity costs, okay, great. Thank you.

Michael Mendes: Thanks, Diane.

Operator: Your next question comes from the line of Barry Sine.

Barry Sine: Good afternoon, gentlemen.

Michael Mendes: Hi, Barry.

Barry Sine: In terms of, again going back to the question of the better than expected quarterly results, you mentioned in your comments the timing of the harvest, which was a

little bit earlier. Was that out of the ordinary? Can we attribute some of the better than expected numbers to the timing of the harvest, or was that as expected?

Michael Mendes: A slight contribution there. I think most of that is on the in-shell side, Barry. The in-shell business, specifically the European business on walnuts, we do have a breaking point at the end of October. And if a crop is earlier, we will ship a lot more in October. If a crop is later, we might have those shipments move into November. We saw that last year.

So some of those shipments that last year had moved to the November period because the crop was so late, this year did ship in October. So that did contribute a bit to that. And also the dollar exchange rate has been very favorable for exports, and so we did have some opportunity for spot sales at attractive prices that slightly contributed to that.

Barry Sine: The export product, that shows up in the international revenue line, not the in-shell, right?

Michael Mendes: This is correct.

Barry Sine: Okay, good. In terms of the snack nut growth up 21%, the last 12 months up 30%, you are guiding towards an acceleration of the growth rate and I think the key fact you are citing is an increase in distribution points. Is that something you have got good visibility on? Do you have agreements with new customers to stock the product, or is that still something that you need to achieve in order to make the guidance numbers?

Michael Mendes: We have good indications, but in the end of the day, until you actually achieve the growth, you are projecting forward. I would say if you look at the component parts of our guidance for this year, one part of that is having an improvement in the velocity. I think that we have seen some very good indications with our IRI data. I think if you look I think it is more than just a quarterly phenomenon. You look at the last 11 IRI periods, our sales are up 30% or more during 8 of those 11 periods.

Those are four-week periods. So I think that is a good indication of the strength of the brand and the same-store sale velocity. The other two components of our growth objectives are new products and then increased distribution, not only in existing retailers, but also channels that we are lightly penetrated or we have no penetration at all. And so I would say that we are pleased with our movement.

One of the best indicators of getting new distribution is how well your product is moving, where you have distribution, and so we feel that we have got some very good indications that are very helpful in selling these products in. We mentioned some of the new products that we have got on tap, such as this Cocoa Roasted Almond product, that we think are very interesting and we think we have got some very good tools to help us achieve our guidance.

Barry Sine: And in terms of the price increases that you have talked about, if you could give us a sense of, is that culinary, snack, what revenue categories is that in? And is part of that just due to a mix shift towards the higher price points, or where are we getting pricing increases?

Seth Halio: Yes. Most of the increase, Barry, is in culinary, and I would say proportionally, when you look at the commodity type, most of it is in walnuts, with some in pecans as well. Interestingly, you know, almonds, because of, the large crop there is this year, we haven't been as aggressively taking price up, and in some cases, the price has come down. When you look at the overall average price, it is not quite as high as you might otherwise think because of that phenomenon.

Barry Sine: Okay, and in terms of the guidance as we think about the next, the remaining three quarters of the fiscal year, you have given an ad number for the full year, also given a second fiscal quarter EPS number. It looks to me, and maybe you can correct me if I am wrong, that ad spending may be a little bit up sequentially in the second quarter. Or is it going to be more linear?

Seth Halio: No, that is correct. I would estimate our ad spending would be up versus, say second quarter of last year. It is probably going to be up around \$2 million higher, maybe a little higher than that.

Michael Mendes: One of the factors that is still at play, Barry, in our considerations, is our media buy with our new television commercials. We are in a very unique cycle, in that with the strike that has impacted television, that has really had an impact on the attractiveness of certain programming, due to sort of a one-time phenomenon we are seeing now related to programming.

The other issue is we have the selection cycle, which is also going to impact the cost of certain mediums. So we will be evaluating the most effective way to deploy our media dollars, and that might impact our timing slightly in ways that we are not aware of at this moment in time. So that would be some of the noise out there that we are still having to work through.

Barry Sine: Okay, and the last area I wanted to touch on, Seth, I notice you have already gotten the 10-Q filed, so somebody is getting lots of high energy from snack nuts. In terms of the balance sheet, and I think I understand this, but the cash position has gone down pretty significantly. I am assuming that is just the normal seasonality, as you take in the harvest, fill your silos. Can you talk a little bit about the sequential changes in the balance sheet we are seeing?

Seth Halio: Yes, that is exactly right. It is the impact of the seasonality. As you know, the first quarter is typically our largest sales quarter of the year (so we have a lot of spending going on there) as well as when we received the full walnut crop by the end of the first quarter, and we make our initial delivery payments on that crop for the full amount that we receive during the period as well.

Barry Sine: Okay. Those are my questions. Thank you again very much.

Michael Mendes: Thanks.

Operator: Your next question comes from the line of Ken Zaslow with BMO Capital Marketing.

Ken Zaslow: Hello.

Michael Mendes: Hi, Ken.

Ken Zaslow: Couple of quick questions. On the international business side, the number seemed up very strong in the sales number. Can you talk about your strategy in international? Is this something that we should start to expect that you are focusing again on this? I may have missed a little bit on that. You know, it seems like that was a lot bigger number than I would have expected.

Michael Mendes: You know, Ken, I think what you are seeing there is more a matter of timing. Obviously people who observe walnut pricing would note that the current commodity pricing for walnuts at are historical high levels.

We had an opportunity to participate in some sales on the international side, where due to the currency situation, we were able to secure some very attractive pricing for some commodity products that would ship in this close-in period. I think that while we are not projecting anything about walnut prices in the next 12 months, we do recognize that prices are extremely high right now.

We also note that the pecan crop is very large, and pecan prices have weakened, and that that could affect downstream walnut pricing, so we felt it was prudent to take some of this international spot sales opportunity in this quarter, rather than to sell that later in the year. This is good math at, you know, getting the cash in early and selling the product, we thought was prudent.

Seth Halio: And I think as Michael mentioned earlier, Ken, because of the earlier walnut crop this year, we were able to make more of our international shipments in Q1 versus a year ago.

Ken Zaslow: So there was some sort of timing issue with that. Is there an EPS contribution that you can assign to that?

Seth Halio: Well, I would say it is probably lower than average, because of the nature of the channel, and the product being non-retail and so forth.

Ken Zaslow: The other thing is that I noted that you took out the line in your guidance that non-retail sales would be down 25 to 35%. I am assuming that's on purpose. What

has changed on that side, and is that the reason that you are raising the guidance on the sales side?

Seth Halio: No. I think when you actually run the numbers, it will still be pretty much within that range. So we still think, we haven't changed that, as we said on the call. We haven't changed our guidance other than the total sales number.

Ken Zaslow: So the total sales number being higher is largely coming from where, I guess?

Seth Halio: Well, I would say it would come more from the non-retail side.

Ken Zaslow: So culinary and in-shell?

Seth Halio: No, non-retail - international and ingredient.

Ken Zaslow: Okay. So again, you are not expecting the non-retail to be down 25 to 35% anymore?

Seth Halio: Well, I think even with the additional sales, it still fits in within that range. That is what I am trying to say.

Ken Zaslow: And then in terms of, I didn't hear, I just want to go back to the question that was asked. Did you lock in contracts for the back half, and how confident are you? I didn't understand the answer to that.

Michael Mendes: I don't know if I heard that question, Ken, so why don't you just give me the question that you have, because I don't think I had that specific question.

Ken Zaslow: The person before me or two people before me asked the question, you know, did you lock in contracts in the snack nut for the back half of the year, to give you the confidence that you are going to be hitting a rather high acceleration in your snack nut sales?

Michael Mendes: Again, we don't contract the snack business, it is not that nature of a business. Just like every year, in order to achieve new distribution which we have got a strategy on how to achieve that. We have got new products that we are trying to get in the market and drive sales from that, and we are trying time prove the sales velocity, and we think we have got, we have got the plan in front of us to execute to achieve our guidance growth. But nothing is locked in. And the same has been the case in previous years with our snack growth.

So we think we have got a good start, and I am particularly pleased with our movement at retail, whereas it has been our first channel, and we have been in that snack channel now for well north of three years, and it is just nice to see the velocity continue to improve with our products and that based item, which is the best lead indicator that we have.

Ken Zaslow: And my last question is, is it at least fair to say that the low end of your range can be cut out? Is that fair given the quarter that you enjoyed?

Seth Halio: The low end of the sales or EPS?

Ken Zaslow: The EPS. So \$0.80 to \$0.84 is probably is probably not the likely scenario, although you are not officially raising guidance, is it fair to say--

Michael Mendes: Well, Ken, It would take all the fun out of your job if I got that fine with our guidance here, so I want to want to give you some job security here. That is going to be your work there, but we are not changing our earnings guidance at this point in time.

Ken Zaslow: Okay. Great. Thank you.

Michael Mendes: Thanks.

Operator: And your next question comes from the line of Heather Jones.

Brett Hundley: Hey, guys. This is Brett. How are you?

Michael Mendes: Hello, Brett.

Brett Hundley: Hey, Seth, did you give or break out North American retail by store type?

Seth Halio: No, we have not.

Brett Hundley: Okay.

Seth Halio: I can get that to you, Brett.

Brett Hundley: Okay. And then Michael, international was strong for you guys and I don't know if I'm reading it incorrectly, but we are looking at October in-shell exports and they seem lighter than last year, which included that late harvest. Am I reading that right, or what is the explanation for that?

Michael Mendes: For which month are you talking about?

Brett Hundley: October.

Michael Mendes: Yes, there is a lot of noise in those numbers obviously. You know, September is also a period of in-shell shipments. I think if you looked at September, September was stronger than a year ago. Look at the two together.

I think one thing to look at with the international commodity portion of our sales is you've got in-shell or kernels, that we are really looking at, what is the way to optimize the marketing of that commodity for us, which could be the in the in-shell form, or it could be in the shelled form, selling to re-baggers or to retailers who are co-packing the product there. So when you combine the two together, that was a bit stronger than a year ago. And also the price per pound, the selling price per pound was quite a bit higher.

Brett Hundley: Okay, thank you. And then where are you guys on adding the packaging line improvements that you were speaking about, and would that be part of that gross margin improvement of approximately 100 basis points year-over-year? Speaking to the packaging, I think there were two packaging line improvements that would bring you from start to finish?

Gary Ford: Brett, this is Gary Ford. We are just in the middle of that. I would say we are about 25% completed. So there was some improvement related to that, but there is still much more to come. For example, the PET line that Seth mentioned, that will be up and running in about two weeks. So we still have that margin improvement to look forward to.

Brett Hundley: All right, thank you. And then lastly, Seth, the interest expense was a little bit higher than we had forecasted. Could you run through that with me quickly?

Seth Halio: The interest expense, well I think, are you comparing it versus last year?

Brett Hundley: Yes.

Seth Halio: Yes, I think when we came into the year at the beginning of '07, we had more cash on hand than we did at the beginning of this year, and then our spend was sooner this year. And again, for example we make payments upon delivery for the walnuts. So because they were earlier this year, we made the payments earlier, and drew down against our lines earlier. So that would account for some of it.

Brett Hundley: All right, thanks, Seth. That is all I have. Congratulations on a good quarter, guys!

Seth Halio: Thank you.

Michael Mendes: Thank you.

Operator: And there are no further questions at this time.