Final

Q2 FISCAL YEAR 2008 EARNINGS CONFERENCE CALL

March 11, 2008, 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 investor conference call and webcast to review the financial results of our fiscal 2008 second quarter, which ended January 31.

Before we get started, we need to cover several housekeeping items.

- First, a printed copy of our prepared remarks is currently available on our website 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 two hours after the call's conclusion, and will remain available until midnight Eastern Time on March 18, 2008. The dial-in number to access the replay from the U.S. or Canada is 1-800-642-1687, and 706-645-9291 elsewhere. The conference ID required to access the call, regardless of the number you have dialed, is 3570-5785. In addition, this call is being webcast live with a replay also available on our website.

- Third, we want to remind you that during the course of this call we will make forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995, including projections of our results. Since actual results may differ materially from projections made today, I encourage you to learn more about the risks and uncertainties that affect our business by reviewing our SEC filings under the heading “Risk Factors.”

Note that our projections or 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:

Thanks Bob. Good afternoon everyone, and thank you for joining us. Since we reviewed our preliminary results at the CAGNY conference in February, we’ll keep our prepared remarks brief today.

Joining me on our call will be Steve Neil, our new Chief Financial and Administrative Officer. Welcome, Steve.

At the beginning of the fiscal year, we established some very aggressive financial targets, the heart of which was to demonstrate that this business is capable of delivering compelling profit growth. After posting strong profits in the second quarter, we believe we are well on our way to achieving our full-year EPS guidance of $0.80 to $0.90 per share. On a GAAP basis, this would represent growth of more than 50 percent.

Our earnings growth is indicative of the progress we’ve made in improving margins despite higher input costs. As a result, we expect to deliver positive earnings in both the third and fourth quarters, compared to prior years when the third quarter has typically generated a net loss.

Let me take a few moments to highlight some of the areas that support our confidence in achieving our 2008 earnings target, and position us for continued growth in the future.

- Culinary sales increased 17 percent during the quarter, and are now 12 percent ahead for the first-half of the year, demonstrating the pricing power of our brands. Importantly, we protected our retail distribution, and believe that the full impact of this pricing should benefit us in the future. Growth in the quarter was strong across all channels, led by expansion in the mass merchandiser channel. In traditional grocery, we ran a successful culinary tie-in with Hershey's chocolate, which drove incremental display activity. We also ran an integrated print and online program around the holidays which increased traffic to the recipe section of our new redesigned website, diamondfoods.com.

- In snack, we elected to modify our consumer support program to spread our investment throughout the year. Last year we ran an in-and-out promotion in the value channel, which we elected not to repeat this year. In addition, we strengthened the quality of our distribution by more aggressively rationalizing less profitable SKUs. Even though sales declined 8 percent in the quarter, we preserved our market share from the prior year.

  According to syndicated data released last week, the brand grew 21 percent for the full year ended February and market share is up 90 basis points. Even in the month of February, when we went up against a 38 percent growth comp from last year, the brand grew 7 percent. We continue to gain retail distribution as Emerald grew 300 basis points to 87 percent ACV. While we have a broad retail presence, we continue to have ample opportunity to increase distribution of the distinct items which represent the core of our product offering.

To enable our retail activation strategy, we have a series of compelling in-store promotional partnerships scheduled for May through October with Coca-Cola, Yellow Tail wine and Heineken. It is important that we continue to identify partnerships that bring new consumers into the category, as syndicated data indicates that 77 percent of Emerald's growth is incremental to the snack nut category.

Expanding the category, as well as low interaction with store brands, is critical to our retail partners. Combined with Emerald's demographic profile (which skews towards younger snackers) this data validates our strategy to primarily target additional shelf space from regional brands. These regional brands represent a significant portion of the category. However, they typically lack national supply chain capability, compete with retailers themselves by pricing at parity with the store brand, and have limited product innovation and consumer support.

Some examples of the innovation we are bringing to the category include the launch of Emerald Sea Salt & Pepper Cashews and Cocoa Roast Almonds. Both products have begun to make inroads in grocery, and we will begin a test with Cocoa Roast at 250 club stores this month.

The appeal of the brand continues to translate into progress in securing new distribution in other channels, as well. This month, we'll begin shipping three more items to Home Depot's nearly 1,700 locations, which will give us a meaningful presence at checkout. We are also pleased to announce that we are entering a new retail channel in the fourth quarter with the introduction of four new single serve items in 4,000 Blockbuster Video stores.

- In-shell and international sales are on target with our projections for the year. The earlier walnut harvest shifted sales to the first quarter, resulting in a decline in sales in the second quarter compared to last year.

- We continue to right-size our ingredient business as we focus on value-added products, and customers who value quality and service. As a result, the profitability of this segment improved, albeit on a smaller base.

- We launched two new "Natural Energy" television commercials in the second quarter during the Emerald Bowl, whereas last year we began the ad campaign during Super Bowl in our third quarter. This resulted in a $2.3 million increase in advertising spending during the quarter compared to last year – and it is worth noting that the incremental investment cost about $0.09 in EPS. We expect this timing impact vs. last year to "normalize" by the end of the third quarter.

In conclusion, we continue to manage our business with an emphasis on long-term profitable growth, and we remain on track to realize our aggressive earnings targets for the fiscal year. With that I would like to turn the call over to Steve Neil.

Steve Neil:

Thanks Michael and good afternoon everyone. It is great to be on board. Since this is my first conference call with Diamond, I'll keep my remarks brief and focus on some of the financial highlights during the quarter rather than repeat the press release or the 10-Q, both of which have been filed today.

- Our mix of sales to the retail channel increased 700 basis points over the second quarter last year to 77 percent, driven by higher culinary sales and lower non-retail sales. This reflects the strengthening of our brands and is consistent with our strategy to shift sales to higher margin products.

- Gross margin for the quarter was 16.8 percent, well ahead of last year's 14.2 percent. Gross profit per pound shipped increased 48 percent to 55 cents in the quarter, reflecting aggressive pricing in order to offset an increase in COGS per pound of 21 percent. The COGS increase was driven by higher input costs and to a lesser extent the loss of volume leverage.

- SG&A expense, excluding stock compensation, was $8.9 million compared to $10.2 million last year. This improvement of about 12 percent reflects a concerted effort to tightly control costs, lower inspection fees tied to a smaller walnut crop, and some timing items between periods.

- This all results in EPS for the quarter of 17 cents per share, up 31 percent compared to last year's EPS of 13 cents. If you recall, last year's EPS included net income from non-recurring items, and excluding these items, EPS grew 42 percent in the current quarter. This puts us at $0.69 in year-to-date EPS which is 15 percent over last year's non-GAAP number, and we are well-positioned to realize $0.80 to $0.90 in EPS for the full year.

- Our net cash position for the quarter was $39 million, compared to a net debt position at the end of the first quarter. For the six month period, we generated cash flow from operations of $30 million compared to a usage of cash of $9 million last year. During the second quarter we extended one of our credit agreements for another three years with favorable terms, so the balance sheet looks quite strong and has lots of dry powder.

- Additionally, we paid a four and one-half cent per share dividend on January 31, which is 50 percent higher than what we paid last year.

Our full-year guidance remains unchanged from what we stated at the CAGNY conference in February. To summarize:

- Net sales of between $522 million and $540 million, snack net sales of between $85 million and $95 million, and North American Retail net sales growth of between 8 percent and 13 percent;
- Our gross margin guidance is for about a 100 basis point improvement over last year's 15.0 percent, reflecting our confidence in maintaining pricing and focusing on cost cutting initiatives;
- Advertising expenditures of between $20 million and $22 million;
- Earnings before interest, income taxes, equity compensation, depreciation, amortization and other (Adjusted EBITDA) of $35.9 million to $38.5 million;
- EPS of between $0.80 to $0.90.

For the three months ending April 30, 2008, we expect net sales of between $93 million and $103 million, and EPS of between $0.04 and $0.08. Note that the third fiscal quarter is seasonally the slowest quarter for Diamond.

That's enough numbers for now so I'll turn the call back to Michael.

Michael Mendes:

Thank you, Steve.

With that, we'd like to open the call for questions.

[Q&A]

Michael Mendes:

Before we conclude our call today, we wanted to remind you of a few upcoming events.

We are presenting at the Sidoti Conference in New York in March, and the Piper Jaffray Conference in New York in June. For more information about these and other upcoming investor events, please check our investor calendar on the Diamond website.

This Sunday, we are proud to host the “Emerald Across the Bay 12K” which is recognized as the best bridge run in America. So if you have never had a chance to run or walk across the Golden Gate Bridge, we encourage you to join us and enjoy our healthy Emerald and Diamond products after you cross the finish line.

Thank you for joining our call.

*** END OF PREPARED REMARKS ***