

## **Q3 FISCAL YEAR 2008** **EARNINGS CONFERENCE CALL**

June 3, 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 third quarter, which ended April 30.

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](http://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 June 17, 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 4667-5159. 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, we 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.

Participating with me on our call today will be Steve Neil, our Chief Financial and Administrative Officer.

We are very pleased with our operating performance for the third quarter. Based on our progress in generating earnings which exceeded consensus projections, we are raising the lower end of our full-year earnings guidance from 80 - 90 cents per share, to 85 - 90 cents per share. Diamond's projected 2008 earnings represent a 60 to 70 percent increase as compared to last year.

North American Retail sales are trending towards a healthy 8 to 13 percent growth rate as we sustain our focus on the branded and value-added segments of our business. We continue to right-size our ingredient and international business, and as a result, our full-year top line is expected to remain relatively flat as compared to last year. Due to this continued mix shift in our business, we expect retail sales to represent nearly 70 percent of sales, up from 64 percent last year. Expanding the proportion of our branded, consumer focused business is

a critical indicator of our progress in structuring the business to enable long-term profit improvement.

During the third quarter, our top line grew 3 percent as a result of the continuing mix shift into higher-margin retail business. Led by snack growth of 39 percent, North American retail sales grew 16 percent for the quarter. Our steady penetration in the snack category was encouraging since we faced a significant spike in competitive activity during the quarter.

In U.S. grocery, Emerald had a 5.5 percent market share for the quarter and posted 14 percent growth for the 4-week period ended April 19 while the category leader declined during this same period.

We continue to make progress expanding our retail footprint, as demonstrated by Emerald's retail distribution increase of 300 basis points to 87 percent. Leveraging the appeal of our new products such as Cocoa Roast Almonds and Sea Salt & Pepper Cashews, we increased distribution of our core, premium tree nut items such as Mixed Nuts, Roasted Almonds, and Cashews. Each item posted over 30 percent growth during the month, and averaged a gain of 6 distribution points.

Looking ahead to the 4<sup>th</sup> quarter, we will drive snack sales in grocery by expanding our promotional tie-in with Coca-Cola as compared to our initial launch of this program last year. In the drug channel, we are making progress in our strategy to utilize shipper displays to capture incremental sales opportunities. One example of our execution of this strategy is Rite Aid, which will feature our 40 count *Power Panel* display in 3,000 stores during July and August. In the club channel, we are conducting in-store sampling demonstrations of Cocoa Roast almonds in over 150 locations which carry our new 38 ounce club pack. In the mass merchandiser channel, we will begin initial shipments of Breakfast-on-the-Go, our new trail mix offering located in the breakfast aisle. The rollout has been expanded to 2,900 stores, and will be on shelf in July.

Some of this new distribution will help offset the volume we are lapping from an in-and-out program we ran in the club channel during the 4<sup>th</sup> quarter last year. We also will continue to capitalize on new distribution opportunities to position us to achieve our long-term growth objectives. As a result, we will incur incremental slotting (which is contra revenue) that may have a greater impact on net sales this fourth quarter as compared to the same period last year.

Culinary sales increased 7 percent during the quarter, and are now 11 percent ahead for the year. Since the 3<sup>rd</sup> quarter is not our primary promotional period for culinary nuts, most of the growth came from pricing instituted in the first half of our fiscal year in order to offset higher input costs. Our ability to take pricing while maintaining revenue growth is a reflection of the strength of the Diamond brand. This is best illustrated in the grocery channel, where Diamond's average selling price per pound was up 16 percent during the quarter while distribution remained steady at 90 percent.

Despite a smaller walnut crop last fall, we elected not to purchase additional raw material for our non-retail business, and instead chose to rationalize less profitable business while protecting and preserving strategic long-term customers. As a result, sales declined about 15 percent in this segment, while gross margins doubled.

In summary, we continue to manage our business with an emphasis on long-term profitable growth, which has allowed us to raise the lower end of our EPS guidance for the year. With that I would like to turn the call over to Steve Neil.

**Steve Neil:**

Thanks Michael and good afternoon everyone. I'll keep my remarks brief and focus on the key financial highlights for the quarter. Please note that both the press release and 10-Q were filed today.

- Our mix of retail sales increased 720 basis points over the third quarter last year to 66 percent, driven by higher snack and culinary sales, and lower non-retail sales. This is consistent with our strategy to shift sales to higher margin products.
- Gross margin for the quarter was 17.3 percent, well ahead of last year's 14.1 percent. Gross profit per pound shipped increased almost 70 percent to 63 cents in the quarter, and this was despite lower volumes and higher input costs that resulted in an increase in COGS per pound of 31 percent. The gross profit improvement was driven by favorable product and channel mix, as well as the benefits from a number of cost efficiency initiatives. Examples of these initiatives include where:
  - We increased snack processing and packaging efficiency in our Stockton facility by more than 10 percent in non-commodity areas;
  - We invested in two major energy reduction projects (HVAC and lighting) which has reduced our plant energy usage and lowered costs on an absolute basis;
  - We also instituted a forward warehouse reduction plan that lowered both inventory levels and miles driven;

These are just a few of the projects focused on long-term efficiencies.

- SG&A expense, excluding stock compensation, was \$8.2 million compared to \$8.1 million last year on a 3 percent greater sales base. On a year-to-date basis, spending is down \$1.6 million, or 6 percent, while sales have increased 2 percent.

- Advertising expense was \$5.3 million compared to \$7.3 million in Q3 last year, and \$17.1 million through 9 months compared \$15.6 million last year. The differences between the years are due to timing. Full-year spending should be between \$20 million and \$22 million.
- This all results in EPS for the quarter of 7 cents per share, up from last year's loss of (25) cents. If you recall, last year's EPS included 20 cents in pension and restructuring charges partially offset by about 4 cents in discrete tax adjustments. Excluding these items, EPS grew from a loss of (9) cents last year to a profit of 7 cents this year. This puts us at \$0.75 in year-to-date EPS which is 53 percent over last year, and we expect to earn \$0.10 to \$0.15 in EPS during Q4, compared to \$0.05 last year.
- Our net cash position for the quarter was \$5.4 million, compared to a net debt position of \$22.9 million at the end of last year's quarter. For the nine month period, our usage of operating cash flow was \$(3.3) million compared to a usage of \$(35.8) million for the same period last year. For the full-year, we expect Adjusted EBITDA to be between \$36 million and \$38 million.
- And finally, we paid a four and one-half cent per share dividend on April 25, which is 50 percent higher than the dividend we paid in Q3 last year.

From a full-year guidance standpoint, we've left our sales guidance unchanged, but raised the earnings guidance to \$0.85 to \$0.90. This change reflects improvements in gross margins, which as we indicated in the press release, should be at least 16.5 percent, or 150 basis points above last year.

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

**Michael Mendes:**

Thank you, Steve.

At this time, 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 Piper Jaffray Consumer Conference in New York (next week) on June 10, and the Longbow Securities Conference in New York on July 1

For more information about upcoming investor events, please check our investor calendar on the Diamond website.

Thank you for joining our call.

**\* END OF PREPARED REMARKS \***