Q4 AND FULL FISCAL YEAR 2008 EARNINGS CONFERENCE CALL

September 25, 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 fourth quarter and full year, which ended July 31.

Before we get started, let’s cover a few 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 telephone replay of this call to be available about two hours after the call's conclusion, and will remain in effect until midnight Eastern Time on October 2, 2008. The dial-in number to access the replay is either 1-800-642-1687 or 706-645-9291, and the conference ID is 6242-0021.

In addition, this call is being webcast live, and a replay will be available on the website.

- Third, we want to remind you that during the course of today's 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 these projections, 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 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 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.

With me on our call today will be Gary Ford, our Chief Operating Officer and Steve Neil, our Chief Financial and Administrative Officer. Andrew Burke, our Senior Vice President of Marketing, will also be joining us for questions as we conclude our opening remarks.

Fiscal 2008 was an outstanding year for Diamond Foods. We demonstrated the intrinsic profit generation potential of this business, particularly during a period in which we faced record high input costs while funding significant brand building investments to strengthen our snack portfolio.

In the third quarter, we raised full-year 2008 EPS guidance to 85-to-90 cents per share. We are pleased to report that we succeeded in beating this range by earning 91 cents per share, posting 72 percent growth over last year.

Two major factors behind this profit expansion are the effective execution of cost reduction initiatives and strong growth in our retail business. Let me turn the call over to Gary Ford to review our progress in these areas.

Gary Ford:

Thanks Michael.

We have made some great progress in our operations area to lower costs and improve efficiencies. Some of the most impactful include:

- Restructuring several areas of our walnut receiving and processing operations, including consolidating in-shell processing in Stockton and eliminating some off-site storage locations. These actions saved us over $1.5 million.

- We also optimized the utilization of the Dried Fruit Association (DFA) inspection services, saving us $540,000.

- We reduced the cost of our packaging operations by $350,000. Most of this came from the installation of a PET packaging line that was instrumental in our successful launch of Cocoa Roast Almonds and Sea Salt & Pepper Cashews into the club channel.

- And, we reduced warehouse and shipping supplies, which saved us $250,000.

In addition to these projects, there were several others which not only saved money, but were environmentally friendly:

- We streamlined our distribution network in order to reduce miles driven and finished goods inventory. By consolidating seven retail forward warehouses into four, we saved over $1 million and offset fuel surcharge increases.

- We installed a new HVAC system in our Stockton plant that allows us to separately manage the temperature of each zone in our 120,000 square foot refrigerated storage area. We estimate the annual savings will be approximately $600,000.

- We completed the installation of motion-sensing, high efficiency lighting fixtures, and estimate energy savings of approximately $135,000.

Another major contributor to profit expansion was the continued growth of our branded North American Retail business, which was up 24 percent during the quarter and 11 percent for the year.

- In snack, one of our key execution initiatives for fiscal 2008 was to increase distribution of the core ten Emerald items, and we did so by growing our shelf presence by 28 percent. This initiative will continue to be an important area of focus during fiscal 2009.

- Innovation continues to be the cornerstone of our growth strategy.

  - Our recently launched Cocoa Roast almonds and Sea Salt & Pepper cashews are among the top ten fastest growing snack nuts in U.S. grocery.
  - Breakfast-On-The-Go, which was launched in the mass merchandiser channel in June, has now gone through several re-order cycles and consumer takeaway has exceeded both our expectations, as well as our customer's. We are now evaluating how we will expand the line.
  - In fiscal 2009, we plan to launch additional new items. One of these is a line of four, one hundred calorie pack items. This line will feature the following offerings: natural almonds, natural walnuts & almonds, cocoa roast almonds and dry roast almonds. We continue to see growth in portion control across the snack category, and our items will enable consumers to enjoy a nutrient

dense, flavorful snack that only Emerald can deliver.

- Culinary sales increased 39 percent during the quarter, and finished the year at $240 million, up 16 percent. We successfully executed three price increases for Diamond-branded products primarily due to higher input costs, and we still gained volume. Importantly, we are seeing the culinary nut category grow over the recent quarter which we attribute to consumers reducing their number of out-of-home meals, and preparing more meals at home. Diamond is well positioned to educate these consumers to the benefits of culinary nuts as a simple, wholesome, versatile ingredient that complements any meal.

Now I'll turn it back to Michael.

Michael Mendes:

Thanks Gary. On September 15, we completed the acquisition of the Pop Secret snack business. Pop Secret is an exceptional addition to our snack portfolio. It enhances our distribution footprint in the snack aisle, is well suited for our supply chain, and expands the breadth of our offering to our target consumers. Our focus over the next few months is on the rapid and effective integration of Pop Secret into our snack business. We are planning to host an analyst meeting in New York at the NASDAQ market site on January 27. By then we will have had more experience in managing the Pop Secret business, so we expect to provide a more thorough overview of this category and how we plan to integrate this line into our larger snack business.

In August, we announced the addition of Lloyd Johnson to our leadership team as Executive Vice President and Chief Sales Officer. Lloyd has extensive experience in the food and beverage industry, having served in leadership roles at Kraft, Nabisco and E&J Gallo. Gary Ford will expand his role in managing our operations and supply chain in light of the acquisition of Pop-Secret, and will assume a new role in grower services. Gary will also look to help us further expand our sales in the areas of vending, food service and our value-added ingredient business.

Looking ahead to fiscal 2009, we are well positioned for future success. We will continue to right-size our low margin business as we strive to achieve a more optimal mix. This will have a dampening effect on top line growth, but will help to improve margins and allow us to more effectively deploy capital. While retail represented about 70 percent of sales in 2008, we expect this portion of our business to exceed 80% next year with the addition of Pop Secret.

With that I would like to turn the call over to Steve Neil.

Steve Neil:

Thanks Michael and good afternoon everyone. Please note that both the press release and 10-K were filed today.

Let me start with a few comments about the quarter and fiscal year.

- Gross margin for the quarter was 16.5 percent, well ahead of last year's 14.8 percent, reflecting our continuing product mix shift to higher margin sales and cost efficiency initiatives as Gary mentioned. Gross profit per pound shipped increased 36 percent to 61 cents in the quarter despite a 20 percent increase in COGS per pound. For the fiscal year gross margin was 16.6%, well ahead of last year's 15.0%.

- For the full fiscal year, SG&A expense was 8.2% of sales compared to 8.1% last year. Excluding stock compensation, SG&A expense was flat between years as we focused on operating margin leverage through the execution of cost reduction initiatives.

- Advertising expense for the year was $20.5 million, approximately equal to spending during fiscal 2007, and within our guidance expectations.

- EPS for the quarter of 16 cents reflects earlier comments we've made about the business becoming less seasonal from a profit standpoint as we move the product mix towards retail, branded products. As noted on our press release today, EPS for the year was 91 cents, an increase of 72% over last year.

- Our net cash position on July 31 was $54.0 million, compared to $13.2 million at the end of last fiscal year. Adjusted EBITDA, which includes the add back of equity compensation, was $37.2 million, at the high end of our guidance range. Additionally, cash flow from operations in 2008 was $47.1 million, a significant improvement from $3.8 million in 2007. Importantly, this performance demonstrates the attractive cash generation capability of our business.

- And finally, we paid a four and one-half cent per share dividend on July 30, which is 50 percent higher than the dividend we paid in Q4 last year.

Now I want to talk a bit about our new credit facility, the details of which were included in today's filings.

- The new $250 million unsecured credit facility replaces three smaller lines totaling $150 million we had with CoBank and Bank of the West, as well as two 7.35% senior notes totaling $20 million that we had with Prudential and Teachers.

- It is a 5-year agreement with two components, a $125 million term loan that has back-end loaded amortization plus cash flow recapture of excess profits, and a $125 million revolver. Both have floating rates with credit spreads tied to our leverage ratio. The initial credit spreads start at LIBOR plus 250 basis points and then goes down to as low as LIBOR plus 100 basis points.

- We were able to put together an eight bank syndicate through a "best efforts" process, thereby saving underwriting fees, which can be significant. The process was led by Bank of America Securities, and the syndicate includes our legacy lenders, Bank of the West, CoBank, and Prudential, plus new lenders in addition to Bank of America which include Keybanc, Wells Fargo, Wachovia and Union Bank.

- The offering was oversubscribed, so that afforded us the option to upsize it and take out the more expensive long-term senior notes. Since we did so, we'll report during the first quarter of fiscal 2009 a one-time early debt termination charge of about $2.6 million which results from paying a "make-whole" provision on the retirement of the notes.

Now, let me shift gears and provide some more detail about our financial expectations for fiscal 2009.

- As we said during the initial Pop Secret announcement, we expect full-year non-GAAP EPS to range from $1.20 to $1.27. GAAP EPS would be impacted by the early debt termination charge I just mentioned which is about $0.10.

- We expect total sales to be between $585 million and $615 million, driven by North American retail sales growth of between 27% and 31%. Included in this growth is an assumption that Snack sales will be between $175 million and $185 million. Note that the snack number includes a partial year of Pop Secret sales, and as Michael mentioned, we will continue the right-sizing of low margin business during fiscal 2009.

- Gross margins should continue to improve as a result of efficiency initiatives that we are driving in the manufacturing and supply chain areas, the rightsizing of our low margin business, and, of course, the addition of Pop Secret which has higher gross margins than our core nut business. As a result, we expect gross margins to be in the range of 18% to 19%. Let me also note that one of the advantages of having Pop Secret in the portfolio is that it is a much less commodity dense product than some of our snack and culinary nuts. To give you a better sense of this, we expect corn to represent only about 2% of our total cost of goods sold.

- Advertising expenses will range from $26 million to $29 million, reflecting the investments we plan to make in Pop Secret as well as continued heavy support of the Emerald and Diamond brands, and cross promotional activities.

- Interest expenses are likely to run between $9 million and $10 million, reflecting higher levels of debt incurred from financing Pop Secret.

- The effective tax rate should be between 37 percent and 38 percent. This reflects a slightly lower estimated discrete item credit than what we realized in 2008 when our effective tax rate was 35.4%.

- CAPEX was $6.6 million in fiscal 2008, but will increase to between $10 million and $13 million in fiscal 2009 as we invest in some new Pop Secret ideas, information technology improvements, and equipment associated with manufacturing efficiency and capacity.

- For the first quarter of fiscal 2009, we expect the top line to be between $190 million and $205 million, and EPS to be between $0.60 and $0.63, which compares to $0.52 in last year's quarter.

In 2006 we provided performance targets for 2011. Now let me turn the call over to Michael for some comments on these targets.

Michael Mendes

In the past, we have shared our long-term financial targets through 2011 which are comprised of the following objectives:

- Annual North American retail sales growth to average 14% to 18% per year;
- Snack sales to reach $200 million - $250 million by 2011;
- To increase our gross margin to 20% and operating margin to 10% by 2011;
- And to grow EPS an average of 40% to 50% per year over this period.

We are making great progress against these long-term objectives. And, with the guidance we've communicated for fiscal 2009, we are well on our way to accomplishing some of these targets prior to 2011. As a result, we plan to update our long-term targets at this time next year, after we have a deeper understanding of how the addition of Pop Secret will impact our total business.

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

[Q&A]

Michael Mendes:

Thank you, operator.

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

We are presenting at the Wachovia Consumer Growth conference in New York on October 15th, and the Merrill Lynch Small Cap Conference in Boston on December 9th and 10th.

We are a sponsor of the New York marathon, which will take place on November 2, and is part of our Emerald "Final 5" healthy lifestyle promotion. The program features marquee running events throughout the country, and provides an excellent venue for sampling, nutritional education, and to amplify our natural energy brand position.

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

Thank you for joining our call.

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