# DIAMOND FOODS INC.

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## Q&A

Operator: The question and answer session will be conducted electronically. At this time if you do have a question, you may signal by pressing star 1 one on your touch-tone phone. If you are using a speakerphone today, please make sure your mute function's turned off.

We'll go first to Tim Ramey with DA Davidson.

Tim Ramey: Good morning or good afternoon and congratulations.

Michael Mendes: Hello Tim. Thank you.

Tim Ramey: You talked a little bit about using some of the incremental margin from lower net prices to ramp up promotion. And I'm sure the question on all of our minds is how do we really think about that for the next 12 to 18 months?

Your product is benefiting from lower input costs and you are a relatively high priced product. Should we be thinking about shelf price declines or are you just going to try and hold the line and get it all on promotion? What are you going to do?

Michael Mendes: Well, Tim, we have quite aggressively tackled the challenge and opportunity; for example, we hope bring some better shelf price to consumers in the spring in the culinary nut segment and stimulate off-take off the shelf.

The good thing about our business is we really feel that our basic model is very complicit with our retail partners. We know that they're making a percentage of the sale dollars that goes to register. So, on its face for every manufacturer to reduce prices and for total sales dollars that go down is not a way to easily improve profitability.

What they would like to do is find ways that we can partner together and bring more value to consumers that hopefully have them maintain or increase the amount of dollars they're spending in this area.

Some examples are: this spring we are promoting multiple unit purchases on smaller pack sizes in the culinary nut segment. So instead of instead of promoting a discount price off of a larger 1-pound bag, we may be promoting a certain discount off of purchasing two or three smaller sized items like a 2-ounce or 6-ounce packs.

We think that this is the kind of strategy that wins for the consumer, wins for our retail partner and works well for us as a manufacturer.

We do think that because we are coming off of historical high commodity prices and because our fixed cost is a relatively smaller part of our costs of goods sold than more value-added CPG products at retail, we can pass on some of that commodity price deflation at - not at a detriment to our earnings powers of the brand. I hope that gives a little bit of color.

I would say that when you look at something like microwave popcorn, that is actually a category that I think is going to do quite well in this type of economy as people are looking for a good value snack.

A pouch of microwave popcorn may cost 25 cents to 40 cents a unit depending on the size and the pack that you purchase. That's a pretty low cost single serve or multi person snack at home versus other opportunities.

Our culinary line sells in the baking needs area. What we have found is as people are looking for more at home meal occasions, so baking is an opportunity.

And if you look at the leading indicators, the current Nielsen data shows the culinary nut category up in the most recent four and 12-week periods. And in the most recent four week period our growth is more than double the category growth.

Finally on the snack nut category, growth in the four and the 12-week periods is down a bit. But Emerald as a brand within the category is growing quite rapidly.

In the last four week period Emerald enjoyed 19% dollar sales growth and 22% volume growth. And a lot of that is because we bring a lot of innovation and we've got a lot of expansion of new products.

So I think that when you go segment by segment I think we've got a strategy that's going to help us prosper and succeed in this environment. But maybe we're not growing as fast as we would've grown otherwise.

Tim Ramey: Can I just one quick follow-up with the Pop Secret being lumped in with snacks this year? It's a little harder to deduce what is happening with snack nut business. And you just gave us some great metrics there. But how close are we to kind of the magical moment of transitioning to real profitability there?

Michael Mendes: We are growing quite rapidly in the snack nut category. We are getting ready to air three new national television commercials this quarter and we're going to have a lot of media behind that with the March Madness. We are investing and spending against that business in proportion to our growth expectations. So, quite clearly if we didn't do national television this next quarter, that would make that business much, much more profitable given the volume we're against.

So we are still spending against that segment to fuel the growth that that business can drive which would make it less profitable than would be otherwise.

I will say that our profit improvement this year is a significant contributor in that is the improved profitability of Emerald snack nuts in our portfolio as that business is gaining scale.

Tim Ramey: Thank you so much.

Operator: We'll take our next question from Heather Jones with BB&T Capital Markets.

Heather, your line's open. Please go ahead.

All right, hearing no response we'll move on next to Mark Argento with Craig-Hallum Capital.

Mark Argento: Yes hi. Good afternoon.

Michael Mendes: Hi Mark.

Mark Argento: A couple questions around CAPEX. I know you took your guidance down for the amount of capital you're going to deploy back into the business in terms of CAPEX.

You mentioned the one project - the integrated roasting line. What projects have you put up on the shelf that maybe we could expect to see come off at sometime in the future?

Michael Mendes: Our guidance reflected our plans to potentially spend some capital on the Pop Secret business as we made that acquisition. I would say that we put these on the shelf I think that we forecast to serve the unknown of what we would have to do on the capital front there.

We did acquire as part of acquisition a production facility and a lot of equipment with our Pop Secret business. And once we got to know the business, we didn't deem a need for a significant capital spend this year.

We did mention this dry roasting and packaging process at Fisher's which maybe Gary can take a moment just to put a little color around that project.

Gary Ford: We're in the middle of the engineering and design stage right now as we speak. But most of that money will be spent in fiscal year 2010.

We're very excited about the project. It's going to be a totally integrated processing and packaging operation that we believe will give us efficiencies well under the industry average.

Michael Mendes: One thing about the capital spend on that is that when we put out guidance on our CAPEX spend we had thought we might be a little further along with that project.

When Gary challenged our operation team to really have a breakthrough design in terms of integrating the roasting and the packaging lines to really have a very low cost facility we decided it would be prudent to take a little more time to have a much better final product.

So I would just say that that capital is going to be deployed a bit later in terms of when it's going to hit the financials on that project.

Mark Argento: Okay that's helpful. And then shifting gears over to Emerald, you had mentioned the Nielsen data, 19% dollar growth, 22% volume growth.

Can you give us a little bit of color on, new doors growth versus SKU penetration growth, and talk a little bit about some recent wins you've had with the product and give us a little granularity there?

Michael Mendes: Well let me start with that and then I'm going to have Andrew give a little bit of color.

Our sea salt and pepper cashews and our cocoa roast almond are two items that are helping us build out our positioning in the cashew and almond sets. And the Nielsen data supports our strong growth there. So those two new items are two big contributors to our growth.

We've got a regional program with our new peanut items in the Northeast. While it's on a small base, we saw some significant growth in peanuts and the four week period. Our peanut business grew over 30% in a period in which the peanut category was down.

Our major gains on a one-off distribution front are more on the mass merch side where one of our major mass merch customers has taken in three 100 calorie packs. They're going to take another five items in the back half of the year.

Andrew, I don't know if you want to add any more color to that.

Andrew Burke: Yes. Mark, I think it's a continuation of the investment and advertising that we continue to make in the category. We spoke about the fact that we're investing behind cocoa roast almonds.

And we're going to continue to invest in kind of promotional support of the Emerald snack line. Michael talked about some of the new product wins whether it be our dry roasted peanuts or our 100 calorie items. And then I think the other thing that really is starting to take place now is this transition of ours where we've moved to our core items which are more broadly appealing, turning faster and we're getting those into more distribution. That's ended up really driving our sales growth.

Mark Argento: Great. And then just lastly in terms of the guide down on the revenues, it sounds like the pricing you're getting on the wholesale side of the business makes sense to keep a little bit more product in the warehouse for a longer and so kind of the shift from Q4 into Q1. Is that the best way to think of that?

Michael Mendes: Yes that's the largest contributor. Just to give you a little bit of history, most of our premium ingredient customers that are looking for more service and a little more value-added product is where we tend to try to sell most of our bulk ingredient products. They have needs usually 12 months of the year.

Last year was a very unusual situation where prices accelerated in the summer. Supply was very low and we had the good fortune to actually contract and sell most of our ingredient bulk product by the end of July. This year, we're more in a normalized window where there's ample supply and the buyers are looking to buy more on a hand to mouth basis. And for their needs in August, September and October, they're not contracting for here in June and July. They're basically buying what they need, looking for manufacturers or the processors to hold the inventory and sell to them on a spot basis.

So, as we determine how we can best optimize our remaining inventory we felt it would be more prudent to sell a larger portion of our remaining inventory in August, September and the first half of October. Keep in mind that the harvest doesn't really take place until October and shelling the

new walnut crop doesn't really start in earnest until the back half of October. So usually as we get closer to the new crop you can see a little better demand cycle. That's why we've made that choice.

Mark Argento: Got you. Thank you very much.

Operator: We'll go next to Ken Zaslow with BMO Capital Markets.

Ken Zaslow: Good afternoon everyone.

Management: Hello Ken.

Ken Zaslow: Last quarter, you told us that Emerald sales were up over 20% for the quarter. What was it for this quarter?

Management: For the quarter?

Ken Zaslow: Yes year over year. I think last quarter you said it was over 20% growth in Emerald. Is that right?

Andrew Burke: Well we have the Nielsen data that we commented on the call. We really haven't broken out Emerald from a pure sales dollars. But it's up double digit growth yes.

Michael Mendes: Right. But what we shared again our most recent Nielsen data as we're up double digits. And in the last four week period we're up 19.4% on dollars and 22% on volume.

Ken Zaslow: Okay. And then...

Michael Mendes: You know, and that is in a time, Ken, when the category is down 6.5% and the national brand is down double digits.

Ken Zaslow: No I didn't know. You just give it last time. My other question is can you help me understand that guidance for fiscal 2010? It seems lower than I would've thought. And here's my thinking.

Interest expense is coming down. You're doing a great job on the snack nut business. The integration seems like it's going well and commodity costs are going down.

So if I just look at interest, lower interest rates and kind of doing what you guys did, it looks like that's a 10 to 15 cents addition then, accretion, call it 20 or so cents. It just seems light.

What am I missing? It seems like this number is a lot lower and you guys are doing a much better job than that EPS number indicates.

So I feel like there's something better going on there than that number.

Michael Mendes: Well I would say Ken as a guy who's got a market perform on us, and where we're projecting a 25% earnings growth, I don't know how many of your CPG companies at the end of Q2 are projecting a 25% earnings growth into the next fiscal year at this stage of the game. But I'm not apologizing for that number.

I would agree with you though that. I'm happy to hear you say that because I agree with you. I think we're doing well.

Michael Mendes: I do think in this kind of environment we need to have a firm recognition of the headwinds that we're coming into. And I think that we have performed extraordinarily well in light

of the pressure. And when I talk about seeing single digit declines in the snack category and we're driving double digit sales growth, I think part of that sort of healthy respectful is reflected in our numbers.

I do think that it does reflect continued investment in our brands and continued investment in our platform and positioning ourselves for greater growth in the future. And we're not going to be cutting back on spending.

I think that when you look at the Pop Secret business we're pretty excited about that business. We've got a new consumer campaign that we're teeing up for next year. So we'll be on air with national television, consumer support against that brand. We're going to be working on new products. And if we can have some success on the new product front they'll be slotting dollars that we'll have to pay against that.

So as we have modeled out the year. We've assumed the degree of investment that we plan as we look to be growing. I definitely feel that we're in a period that if we can invest in the market we can gain disproportionate marketshare versus a more healthy market environment. So we're going to aggressively try to put ourselves in a better market position. So those projections reflect good performance. It reflects that nothing bad happens that we don't know about. And I think that it does reflect that we're investing quite heavily.

Ken Zaslow: Yes I was paying you a compliment in terms of your business. I don't know, it's fine. I mean you can give whatever guidance you want. It's fine with me. It's just seems like that I add up a lot bigger numbers. That's all I was looking at. But so that's fair.

Michael Mendes: Well again, I guess my only thought was that, we want to try to frame people's thinking. I think that when you see some of the optics of our top line number, anyone who's close to this

will know that there's some underlying issues here that when you feel that commodity deflation on the ingredient business that the business is very healthy.

So we're trying to be helpful to those people who maybe aren't that familiar with our business.

Ken Zaslow: Oh no. I just thought that you would be able to, capture some of the lower commodity costs, the lower interest expense. What I understood was that the Pop Secret acquisition was going smoothly. And in the Emerald business, as you said, it was up 20% the first quarter and double digit in the second quarter. It just seemed like things were starting to click. And I don't know, that's fine.

Michael Mendes: And we will be revisiting our assumptions in Q4. Again normally we're doing this in September. So if you could just frame your thought process we're trying to give an early look at that.

Operator: And next we'll go to Heather Jones again, BB&T Capital Markets.

Heather Jones: I apologize earlier. I was in an airport and an alarm went off. So I couldn't even hear anything. So sorry about that.

Management: Hello Heather.

Heather Jones: I have a few questions. One, on your Nielsen data, the latest four weeks you just mentioned, sales up less than volumes. And I just wonder if that's the introduction of the peanut which is I guess a lower price mix?

Michael Mendes: Yes - that would be right in terms of our mix. You know, it's a modest differential. We're talking 19.4% in dollars and 22% on volume, so it's a modest differential. But, I think you can attribute a bit more on that side.

Heather Jones: Okay. And as far as you talking about the commodity deflation and your more commodity type businesses like an in-shell, et cetera, wondering if looking out to '10, volume growth has been strong in snack and pretty strong culinary. But do you believe that price deflation will offset volume so that dollar sales may actually be flat in '10 or would you anticipate volumes offsetting any price deflation?

Michael Mendes: I think that your former comment could be the case. It's just very difficult to know what's going to happen on that part of the business.

I feel very comfortable and confident about its nominal impact on our earnings. It's the back end part of that business, so I'd say the last third of our ingredient business first go into commodity is in ample supply, has a very marginal earnings contribution for us. As a matter of fact it would maybe modestly contribute to overhead.

So while that may deflate that top line and it could have the impact of having as much of an impact as having sales volumes be flattish towards next year, that should not have any impact really on the earnings driving potential of the business.

Heather Jones: Okay. That makes sense. And going back to Ken's question, and I don't mean this in a confrontational manner. I mean it actually in a complimentary manner as well.

But looking at Pop Secret, how well it's going and interest expense, it sounds as if your earnings projection is conservatively estimating either significant reinvestment in the business or

conservatively estimating that you're not going to get any benefit of cost deflation. And I'm just wondering if you could speak to that.

Michael Mendes: Well again, it is a 25% increase versus the current year. And in the economy that we're in in terms of the global economy that we're in and trying to factor in sort of the unknown reaction of the competitive market, I think it's a prudent guidance two quarters into the current fiscal year.

Heather Jones: It's very strong growth. I wasn't trying to imply it wasn't strong growth.

Michael Mendes: Yes.

Heather Jones: I just was same way as Ken, was getting to higher numbers. And I'm just trying to get a feel for how much conservatism is baked into that guidance given how early it is.

Michael Mendes: Well I would say there's more conservatism in the bottom and in the top end. How's that?

Heather Jones: Okay and finally on Planters. We haven't seen an increase in competitive activity in our market. I'm just wondering what you're seeing there if they ramped up competitive activity?

Michael Mendes: Well, they have a great franchise. And we're trying to grow the category, trying to bring younger snackers in. You know, we're very focused on this 3 o'clock day part mindset natural energy approach to very different demographic and attitudinal direction of our brand. So we're hoping that there won't be that much cannibalization. But I would say that the data has borne well for us. Again, you look at this most recent period, the most recent 4- and 12-week periods. They have been reflecting double digit declines, declining more than the category. And we're reflecting double digit growth. And so we're pleased with our performance on that front.

And we're going - and we feel like the key that has helped us defy the category trend is bringing new value to the set. I think something like a cocoa roast almond, with the idea of giving somebody a snack nut that's got a chocolate flavor that's not a melt in your hand type chocolate that has no more calories than a regular almond, that's a winning play. We're very confident in that item and it's performed well for us.

I think our sea salt and pepper cashew, I mean, it's not exactly rocket science but we were the first one out there with it. And we had a very good reaction to that item. And, I think as we can keep trying to differentiate our convenient packaging, our product types it's going to have a less tendency to commoditize our items.

But I would say that on the competitive front we've not seen a ramp up on the nut side any more so than what we've seen all over the last year.

Heather Jones: Okay. Well thank you and congratulations on your quarter. It was very good.

Michael Mendes: Yes thank you. Thanks for your time.

Operator: We'll go next to Sarah Lester with Sidoti & Company.

Sarah Lester: Good afternoon.

Michael Mendes: Hello Sarah.

Sarah Lester: Wanted to ask about your retail promotions, what you're expecting for the next I guess six months or so. Is this specific to culinary walnuts or are you looking at also Emerald and Pop Secret or yes Pop Secret?

Michael Mendes: Yes. I'm going to take the first half of this and then I'm going to have Andrew give a little more color.

I was referring to the culinary side in my earlier comments mainly because we felt that was an area that we could get some incremental sales activity and then also help our retail partners by bringing them more value by helping them basically scan down the price at the register in the spring holiday.

We quite rapidly this fall formed plans for the spring for our Easter promotion. We also have intensified the depth and the frequency of our promotional activity on the snack side for both microwave popcorn and snack nuts. Let me have Andrew just give a little more color on that.

Andrew Burke: Yes. If you break up the business and you look at our snack business, we'll continue promotions into the spring and summer for both Emerald and Pop Secret. I think the nice thing is as we expand the breadth of our offerings… we talked about this peanut offering. The peanut category represents 30% of the dollars and 50% of the volume, as we start to roll that out that just gives us more breadth that we can go and do more print promotions with our retail partners which is very exciting for us and very exciting for the brand going forward.

And then, as Michael talked about on the culinary side, we are going to be doing a spring promotion and a spring overly via our recipe contest for the first time in many years as we look to spend some of that promotion dollars back to help drive the category.

Sarah Lester: Okay thank you. That's all I had.

Michael Mendes: Thanks Sarah.

Operator: And at this time, there appear to be no further questions. I'd like to turn the conference back over to the management for any additional closing comments.

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