DIAMOND FOODS, INC
Q3 FY2008 Earnings Conference Call Q&A.

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3:30 pm CT

Operator: At this time I would like to remind everyone in order to ask a question, press star then the number 1 on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Ken Zaslow.

Ken Zaslow: Good afternoon everybody.

Michael Mendes: Hello Ken.

Steve Neil: Hi Ken.

Ken Zaslow: Hey, just a couple of questions. One is, can you give us kind of an outlook of how you're thinking about the commodities going forward, and how the crops are coming on and what your perspective is on that?

Michael Mendes: Sure Ken. We'll just start with the walnut crop. Last year we had a walnut - the California walnut crop was about 320,000 tons, and just as a reminder to those people that are on the call, most of the walnuts consumed in North America are U.S. production, so that's kind of the biggest driver to supply and demand.

The two years before that were 360,000 and 355,000 tons, so the 320,000 crop last year was a short crop. Prices accelerated, and going into this upcoming crop, people expected this crop to be large, perhaps the largest crop in history. It's a little early to say, but we would say that in light of the early set of the walnut crop this year, we would think that there’s probably a good chance that we’ll at least see prices stabilizing going into next year with what we see on the crop on walnuts.

As far as almonds, the almond estimate came out and the most recent estimate would project that the crop would be about 80 million pounds larger than last year. And the carry out right now is projected to be about 20 million pounds larger than last year, which would give you an additional 100 million pounds of almond supply this year compared to last year. So almond prices are trading at a level that’s about half the price of walnuts right now in terms of the kernel price basis, so I don’t know if that’s going to mean significant price reductions. I think some of that supply is already factored in the pricing but that could - it might have some influence in that direction if that crop bears out.

As far as the pecan situation, next year is the off crop with pecans. And the off crop in pecans historically has been sort of about 185 million to 250 million pounds compared to north of 300 million that they had last year on the on crop. The inventory situation can somewhat influence total supply, but I would say that conventional wisdom is that pecan prices will be higher next year in light of the upcoming crop.

As far as peanuts and cashews a smaller part of our total mix, but obviously an important business for us going forward as we grow in snacks, the peanut planted acres as reported for the coming fall is reported to be up 15% this coming fall if those actual plantings take place. That should put some more supply into the peanut market which have - might have a tendency to mitigate some of the price pressure we see in that commodity.

So I would say that the potential right now, if those acres that are currently predicted to be planted and peanuts are planted, that that might have a downward pressure on pricing. With cashews, that has been a commodity that had quite a bit of volatility. Cashew prices have increased about $1 a pound over the last six to nine months, and the Indian crop -- the Indian and the Vietnamese crops that are being harvested right now -- based on those crops, we don't see prices weakening. If anything they will stay at their current tight levels. As a matter of fact, there have been people that have been defaulting on contracts.

The Brazilian harvest - the Brazilian cashew harvest takes place in September, so that's probably the next event that would lead to a relief from the cashew prices, and we don't anticipate seeing much relief, if we would see relief, until September.

Ken Zaslow: So, kind of summarizing that, it seems like going in to next year you would argue that your commodity pricing - the pressure from commodities should at least stabilize if not be a little bit - you expect a little relief...

Michael Mendes: Yes.

Ken Zaslow: ...as pool of your commodities on the nut. Is that fair?

Michael Mendes: I would agree with that.

Ken Zaslow: And then in terms of your two largest customers, in your 10-Q you put out, it seems like you are gaining a lot more traction in those two customers. Can you talk about what you're doing differently or is it? I know it's not broken down by snacks versus culinary. Is there something specific to one of the size of it that you're seeing the growth or is it blended; could you just talk about what you're doing special in those two customers?

Michael Mendes: Well I think probably to break it down by business segments, I think what we're doing in culinary versus snack, we have different - drive different results. I think that on culinary, our reliability of the quality behind our brand and our reliability and supply in a period of time that some of our competitors have either compromised their quality or have actually short-shipped customers. I think it has very much bode well for us and it's helped sustain and allow us to get some new items with some of our customers that we have distribution, but we had a chance to get some new items. That credibility has enabled us to pass a bit of pricing that we had to pass on because of input prices, we were able to bear that effectively, and I think the IRI data supports hat that worked our reasonably well for us.

On the snack side, Ken, I think we're learning. I think we've got better packaging, some better new products, better execution of our promotional distribution, and also getting a better selection of items on the shelf on a better location. I think that if you were to look at our retail distribution in terms of which items we had on the shelf and where they were located on the shelf 24 months ago, you'd see quite a different picture than you see today on some of the traditional retailers, and even on some of the mass merchant club partners that we're working with.

So, I'm pleased with the progress. I think that we got a lot of runway ahead of us. I see this as an exciting thing for us is that - I think that if we can execute against our distribution expansion plans by channel and continue to get the kind of velocity we're seeing with our promotional effectiveness, it's should continue to bode well for us in the next 24 to 36 months.

Ken Zaslow: And then my last question is, I know it's early for 2009, but with lower - or at least stabilizing commodity prices, and it sounds like some traction with certain customers and new products, can you shape or give us some levers that we should be thinking about or how you're thinking about 2009? And any, obviously, specifically that would be great, but at least the general parameters of how do we think about 2009?

Michael Mendes: Well, we can give a lot more detail on that Ken in our next call, but let me try to speak towards your question.

I think that on the overall margin front, we're going to be working very hard to improve the cost efficiency of our business. In Steve's part of the call he talked about some of the things we're doing that's going to drive real costs of our system, which we're quite excited about because that's - to me cost reduction that doesn't compromise your service or your quality is a gift that gives forever.

Unfortunately, some of those movements have really gone to offset some increases in fuel and energy costs that we're dealing with in the environment. So, we're not seeing as much of the benefit of that. Hopefully we'll keep seeing the benefit of that; we are investing more on that front.

But I think that we're probably going to see the benefit of that more in the two to three year window. I think you're going to see continued investments in our capital efforts to drive the efficiency of our operating facilities, and take inefficient labor and inefficient processing and yield loss out and try to apply capital to help deal with that which really wasn't an option for us in most of the 90 plus year history when we were capital constrained.

As far as the general commodity environment, if commodity process were to stabilize this coming year, I think we will see a bit of benefit from us not being behind commodity input costs as we deal with our pricing to our trade partners. So, there could be a little continued - that would be a benefit that I think allows us to achieve our long-term earnings projection.

On the snack front, we really are committed to our 2011 target of growing this business - snack business just north of $200 million. And a big charge that we've had here in the company is saying that 2009 will set up 2010. In 2009 we need to really get the right products, in the right retailers, in the right locations, with the right merchandising plans to really fuel the long-term growth of the business.

So while I think that in 2009 we're going to make some nice progress in terms of the trajectory of our snack business, we're probably going to see only a smaller part of the actual sales driven off that because we're going to make sure we get it right, and I think that's a big key. And I think in the past we might have scrambled a bit with a customer if they said, "Gee, you've got 15 items and only two of them are unique to my set." I think we're going to slow down and really try to drive the core items which are the big velocity movers in the set. If I had to be self critical of our enthusiasm to rapidly get on the shelf in the past was sometimes when a retailer came to us and said, "You've got these mainstay items like mixed nuts, cashews, almonds. I like those but I already have one of those, and I have one of those in my own label. Why don't you give me one of these nice unique items?" And then they put that item on the shelf, they want full slotting, and then they expect to measure the velocity against that unique item against a base snack nut like a cashew or an almond or a mixed nut. In the end, that was not the best thing for our franchise.

So, that's why a big drive in our business is to get those core items to less mixed nuts.

Ken Zaslow: Great. I appreciate it.

Michael Mendes: So, that's what I could sort of give you directionally on 2009.

Operator: Your next question comes from the line of Diane Geissler.

Diane Geissler: Good afternoon.

Michael Mendes: Hi Diane.

Steve Neil: Hi Diane.

Diane Geissler: Hi, on your fiscal '08 guidance and the drop-in on the fourth quarter; if I look at your total snack revenue guidance of I believe 85 to 90... That's correct, right?

Steve Neil: Yes.

Diane Geissler: As I look at your snack revenue[guidance] in the fourth quarter, there's a big swing of $10 million, anywhere from down 10% to up 30%. Can you give us some examples of why you would be on the lower end or why you would be at the higher end? You know, one versus the other?

Michael Mendes: Thanks Diane, I'll try to speak to that. We had quite a bit of discussion about that and we have a number of initiatives that we are working the retailers to gain distribution here that would - the timing of that could take place in the fourth quarter. I would say that the natural trajectory of the business is we're probably coming out towards the middle of that guidance right now, and maybe a bit below the middle if we pay some incremental slotting that we're looking at that's a real nice opportunity, but that the timing is basically at the very end of the fourth quarter.

So, that's a little bit behind that, and if we also have some new distribution we're working on that if we actually were to get some of those shipments, we would realize some of that in July which could drive the number up. At current commodity price levels, an incremental customer with their front-end orders can drive a couple of million dollars of sales one way or the other.

And so, our feeling was that it's a growth business; with a lot of volatility on the spikes, the costs and revenue to drive this business. But I think, like anything, it's kind of a rule of numbers. I mean, we're going to be regressing toward the mean here. Over time we're going to see a lot less volatility in our snack business.

At this point of time I think we are - we think it's prudent to keep the broader range to afford us to not do anything to compromise our distribution objectives because we narrowed our guidance.

One thing is that we did have was an in-and-out promotion that was worth maybe $3 million to $5 million that we did in the club channel during the fourth quarter last year that was opportunistic, more like a sampling opportunity to be honest with you, with one of our items, which was a nice opportunity that we partook in. But that was not going to be an annualized opportunity, so, we're going against that number in Q4.

So again I think we're pleased with the trajectory of the business, but I think that on Q4 we think we should be prudent and not be too ambitious with our guidance to afford us an opportunity to invest if we have a chance to, to position us better for 2009.

Diane Geissler: And the new breakfast item that you say will be on the shelf in July, would that have already - it wouldn't have already shipped right? It will ship in the fourth quarter?

Michael Mendes: Yes, it will be shipping in the fourth quarter. So the timing of that will be a factor. For example, we're still going to roll out schedule when that fully will ship. Those are two items and 2,000 stores in one case and 2,900 in the other case.

Diane Geissler: Okay, so two items in 2000, and 2,000 in 2,900?

Michael Mendes: One is in 2,000; one is in 2,900 stores.

Diane Geissler: Oh okay, all right. Got it, thanks.

And then I guess in response to your response to Ken about, how we should think about snack nuts; if I look year-over-year, somewhere around mid teens for '08 versus '07, you want to build, you want to be prudent, you want to build the business right. Should we be thinking a similar growth rate for snack in '09 or do you think you can do something better?

Michael Mendes: I would think that if you're looking at sort of the mid-ish point of our range, than I think we could probably do better in '09. But I think we'll have more color on that our next call, to give you more scale on that. Maybe - but I think we would do better….

Diane Geissler: Are you saying better than the 90 whatever you're going to do this year or better than growth rate...

Michael Mendes: Better than the growth rate.

Diane Geissler: Okay, better than the growth rate, okay. Perfect, thanks for the clarity. And then I guess if I look at your SG&A and the roll off of the IPO equity comp next year, I have that about $2 million, but I'm assuming that there will be higher broker fees as your snack - is that still an accurate assumption?

Steve Neil: Diane this is Steve Neil. Yeah, you're almost right on. Seven to eight cents EPS impact which is right around $2 million for the IPO roll offs. So, you're correct there.

I'll let Michael address the brokerage costs.

Michael Mendes: Yeah, I think brokerage costs will be up a bit, but I think we're going to see more of our growth in the non-brokerage driven channels. So, it won't be proportionately up as much.

Diane Geissler: Okay, so would be accurate to look at… you'll have a benefit from reduced equity comp from the IPO roll off, but it might not be the full seven to eight cents because there might be some incremental broker costs?

Michael Mendes: This is correct.

Diane Geissler: Kind of a convoluted question, but I'm just trying to figure out what the upside...

Steve Neil: Right.

Diane Geissler: ...on the equity comp is in ’09 versus ’08. Okay, and then just one technical question on the tax rate; it looked high in the quarter -- I’m not sure if there’s anything specific going on there.

Steve Neil: Yes, I’ll address that. You are correct; it was 41-1/2%...

Diane Geissler: Right.

Steve Neil: ...versus 38%, and there was just a small discreet item – a one-time item -- that came in. On an on-going basis we still project 38% to be our effective tax rate.

Diane Geissler: Okay, would that be the annual rate then?

Steve Neil: Correct.

Diane Geissler: Okay. Okay, I think that’s it for me now. Thank you.

Michael Mendes: Thanks.

Steve Neil: Thanks Diane.

Operator: Your next question comes from the line of Mark Churchill.

Mark Churchill: Hey, good afternoon.

Michael Mendes: Hey, hello Mark.

Steve Neil: Hey Mark.

Mark Churchill: You mentioned in the press release, competitive promotional activity; can you elaborate on exactly what you're seeing and what your response was to that, and whether that has any potential impact on the snack penetration in the fourth quarter like we saw a couple of quarters ago.

Michael Mendes: We have seen some promotional activity in the third quarter that has abated, we believe, going into the fourth quarter. Actually we've seen some of our competitors, the national brand, taking a price increase in the snack category. So, we don't think we'll see, on the pricing side, the kind of the net pricing promotional activity to the degree we saw in the third quarter.

Mark Churchill: Okay. And then can you provide some more color on the volume in pricing in terms of culinary and exactly what you guys are seeing for (unintelligible) inflation in that business?

Michael Mendes: Yes, it's an interesting thing. When we first took pricing in the category, the biggest concern when you're the national brand and you're leading the category is whether people going to follow and how is the private label going to treat that increase. But, I think that if you looked at our dollar share growth in the 52 week, 12 week and four week periods -- let me just give those to you Mark. In the 52 week period, our Diamond baking dollar share is up 3.7%; for the 12 week period, it's up 5.8%, and for the four week period we were up 11%. So I think what you would note is that there was just a very, very, modest volume decline during that period and that we're holding our distribution, and out loyal consumer base is perhaps at worse case, may be shifting to smaller pack sizes as a reaction to the inflationary environment.

So, while we would always hope people would buy as much volume at the full price as possible, if people can have a reaction in an inflationary environment to sort of stay within our franchise and to trade off to a smaller package size would be the most desirable inflationary reaction we could see and I think that's what we're seeing.

Mark Churchill: Okay, thank you very much.

Michael Mendes: Thanks Mark.

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

Brett Hundley: Hi this is Brett Hundley, how you are?

Steve Neil: Hi Brett.

Brett Hundley: Good quarter. I just wanted to touch on gross margin again, and Steve you touched on this pretty well in your prepared remarks. But, as you look at it, it just continues to improve here, and I mean is that something where you see that trend continuing into Q4? And you can touch on a lot of these efficiencies that you're driving, when they continue to fall in line?

Steve Neil: Yeah. We do expect it to continue into Q4. The efficiency initiatives that we identified, I mean that's an ongoing effort. We identified a little bit of detail there and clearly we've just completed for example, the energy initiatives here in the last couple of months. And so when we get the full benefit of that, that's going to continue going forward.

So, it's either your goal is to whatever your cost increases are, whether it be inflation or commodity, you try to offset it with the - with cost efficiencies, and that's certainly what our focus is. We're not always able to do that, obviously you have to have some price increases. But yeah, we certainly expect that to go forward.

I think the other thing to emphasize over time is we have put in capacity to meet demand in the snack category and to a little bit lesser degree in culinary. And so as you drive more volume through your fixed costs are there, you're going to get some benefits there too. So, as we talk about benefits both in the - by channel and by mix, that's what we mean.

So again, as we grow that's going to be a benefit and we'll continue to realize the efficiencies on the margin side. I think we've stated before that when we get out to 2011, we expect margin to expand up to 20%. So, while it won't be linear, it's certainly going to be directionally correct.

Brett Hundley: All right thank you, that helps. The other question I had was have you guys been seeing a trade-down to private label in snack nut?

Michael Mendes: On the private label front, we've been watching that very carefully. Both in culinary and snack but we saw private label make some gains in the period, but we are pleased to see that a lot of that gains seems to be coming at the expense of the all other brands which are really price sensitive brands that don't have any unique packaging or flavors, and don't have any national consumer support. And so we have seen some erosion from those brands, particularly in the snack category. One thing I would like to refer to private label is as own label. To retailers it is their brand and they take it very seriously, and they treat it as their brand. And part of our value proposition is we have a path to prosperity which is enriching for the retailer and their brand while we can succeed. And so, a big part of what makes us attractive as a new entrant into the category is our ability to grow, to grow share, to - and to not cannibalize the retailer's brand or the national brand, which generally means it comes after these regional, one-off brands that don't support or provide value.

So, I think own label with the retailers brands, are doing well in this segment, but I think that in the end of the day, a national brand, ourselves, and own label is a very optimal environment. And we've moved more in that direction.

So, it's something that is out there… and as long as your brand is bringing value and you have a lot of promotional activity, and you're helping them bring consumers to the set, you can bode quite well in this environment. But it really is a test of your metal as a brand of whether you're bringing something to the party. Because otherwise I think you really risk losing to private label or to the store brand in this environment.

Brett Hundley: Right, right. And then Michael your ingredient segment held in there better than, I think than we had expected. Can you talk a little bit about the performance in that segment?

Michael Mendes: Yeah, we continue to focus on our value-added customers and customer who value the brand. And I would say if you were to profile our core ingredient and food service customers, they tend to be a customer who sells a product that is creating some value for the consumer, so it's a more processed item. Nuts add value in the premium-ness of the product. It helps them sell their product for more money because it adds a distinct (unintelligible) that makes their product more premium. So nuts are not something that adds cost, it's something that adds value. And also that nuts represent a - they're a relative small percentage of the cost of goods sold.

You put all of that together; you're not going to want to see that commodity price inflation, but if it's a pretty small percent of the cogs, it's not going to nowhere near offset the value creates potential of that item. And so our customers… might be a reseller - a bulk reseller who is really a short couple pass through vehicle to some other end customer, they could be very much subject to a very aggressive reduction in demand of their business due to the high inflationary environment.

That makes up a very small subset of our customer base, and that's helped us a bit there. And finally in our international business we continue to take opportunities in this weak dollar environment and walnuts are still very attractive value vis-à-vis other food stuffs given how much the dollar has declined in value versus the Euro in particular. And also against the Yen over the last three or four years.

Brett Hundley: Okay, great. Thanks guys.

Michael Mendes: Thank you.

Steve Neil: Thank you.

Operator: Your next question comes from the line of Mark Argento.

Mark Argento: Good afternoon guys. A couple of - one really question for you here. Now that you've had the snack business now for a few years; can you talk a little bit about your marketing spend. I know you've kind of fixed that out, what did you say $20 million to $22 million. Now that you've kind of tweaked the strategy in terms of go to market, trying to get more SKUs bundled together, trying to drive better penetration that way; has that really affected how you approach your marketing spend. And can you talk a little bit about any changes there that we should be anticipating or any adjustments that you've already made there?

Michael Mendes: Okay, the one thing that sort of belies the marketing spend which due to accounting treatment is quite visible, first the promotional spending which is very important to simulating off-take which is net of sales. When you aggregate the resources against the brand, you're probably looking at promotional support of $30 million plus on top of a $20 million advertising budget. Whereas two and a half years ago we maybe had $10 million of promotion support against that brand.

So, that promotional support is really critical to get the kind of display activity at retail, and it is still quite an impulse purchase category. So when you overlay that incremental promotional support that we're against the power against this category that is quite a resource expansion for us. In addition, we have broker partners that are part of our sales arm that merchandises and manages this category.

As you can imagine, in the region of the country where we have bigger volume and more critical mass and dollars, we buy attention naturally. But there's a lot of regions of the country that on a smaller base, where we don't afford a lot of attention from our retail partners in merchandising the products.

As we've scaled up we're improving our visibility and our capability on that front, and so the aggregate effort that we're able to buy behind the brand is quite a bit stronger today as compared to three years ago just on the scale of the brand.

And the final thing is we're trying to spend those advertising marketing dollars even better. At the beginning there was really no perception of the brand. Now that recognition of the brand has started to register, we're able to spend to really build relevance of the brand. So, I think I would look at it as a critical mass investment. And I think that given that we're having to spend on top of the base that we're operating, it's a good base to operate.

Obviously we would love to keep scale into the business and afford to spend a bit more against it, but we feel very enabled with our current investment level.

Mark Argento: Do you know off the top of your head how much you are spending on line right now, and do you guys look at that channel as kind of a key differentiator for your - that target in your little bit younger demo.

Michael Mendes: You know, for competitive reasons we've not disclosed the specifics. I would like to speak about that for a moment; I think there's two fronts on that. One is I think it's very, very intriguing to us how we can reach out to our consumer base, and you're absolutely right. Because we do attract a bit of a younger demographic, their accessibility is that much greater given that venue. I think that we're still in a bit of a frontier in terms of CPG companies leveraging that instrument to effectively get the consumers. We've got some things we're working on that we think quite exciting. At the end of the week we're - actually next week we're going to refresh our Web site with the changes and improvements, but there's no doubt that we spend a lot more time talking about online resources and how we can institutionalize our efforts on that front as well as periodically exploit that.

I think that as far as more sophisticated - if I can broaden your question, or if I can also speak at least to a broader subject which is more sophisticated tools for us. When we launched this brand, our vehicle to promote an item was a national FSI. We would put in a national FSI in a Sunday circular - a very broad crude instrument – but still a very tried and true vehicle for new product trial, although a bit of a problem when you have spotty distribution from your item. So one thing that we've been doing some work on is a vehicle called

Catalina -- which you're probably familiar with. It allows you to actually go and select a store, select a region, and select a consumer demographic and then not only have a coupon print out on the...

Steve Neil: At the register.

Michael Mendes: Thank you. At the register - at the receipt at the register, not only do you have the coupon - so basically you get a color coupon which redeemed on the back of register receipt -but we can actually change the redemption based on your purchase patterns.

So for example, if our research shows that this consumer traditionally will buy one bag, we will try to give an incentive to get them to buy two. If people normally buy packages, we'll create an incentive for them, if you buy two you get a discount of a third. And the efficiency of that spend we think, is just going to be a better us of our dollars and a better application of our approach.

So, I think kind of the broader subject; are we trying to drive more intelligence in our marketing, I think the answer is yes. I think the online universe, our best days are still in front of us, but we're making progress there.

Mark Argento: Great. Thanks for the color.

Michael Mendes: Thanks.

Operator: Your next question comes from the line of Alton Stump.

Phil Turpollili: Hi, this is actually Phil Turpollili calling for Alton. I wonder if you guys could shed a little more color on the competitive landscape of the new trail mix products. Maybe, you know, what you expect to see there, and also what types of seasonality if anything, we should expect from them. Thanks.

Michael Mendes: Well, there’s always a host of new products out there. We know that on the national brand has got some trail mix items which I think (unintelligible) success with them, but they’re going for a certain price point. I don’t know how much novelty’s there; I know that they’ve got a different peanut product that they’re working out with; I think it’s still early on their distribution efforts there.

We know that Pepsi has a brand that they have introduced in the nut category that’s more of a confection type item. It’s a blend of products, but it’s more of a confection sweetened item. I guess I would consider this to be a new type product to the set.

You know, our whole thinking is that, when national brands bring innovation to the category and spend dollars on marketing to draw consumers to the shelf, that’s great news for us. We don’t really see it’s a better mouse trap against items that we’re marketing, but it’s something we’re monitoring closely. You know, when we look at our - some of our new introductions like the Cocoa Roast Almond, we think that it’s very on trend products. We think that people like almonds; we know that people like chocolate. But generally a chocolate almond is an in-road product that needs to be refrigerated that feels more of a decadence product.

Our new Cocoa Roasted Almond is a - basically it has no additional caloric value as a result of the chocolate roasting, which is very appealing for people who like a nut as a healthy snack, but would like to get a chocolate flavor. So, we really like how we’re lining up on the innovation front versus some of the other players out there. And you know, this is sort of - this is a trench warfare - it's every day what have you done for me lately.

And we like where we are today. We've got some more things up the pipeline and we think we'll bode well going forward.

Phil Turpolilli: Okay great. Thank you.

Operator: Your next question comes from the line of Sarah Lester.

Sarah Lester: My question is about the slotting piece for the fourth quarter for Emerald. You mentioned in your prepared remarks that slotting is going to have a greater impact on the fourth quarter. Can you expand on that a little bit?

Michael Mendes: We don't guide specifically on that component of our costs. I would just say that compared to fourth quarter last year, if we do have an opportunity to get some products in place, we will not slow that down in order to back into a fourth quarter sales number.

Now one of the things, Sarah, about our business that is interesting is that we keep getting better in managing the business. We've set some guidelines as we're working with our retailers as to when we will pay slotting. For example, we're looking to get up to a minimum distribution level with a new level, with a customer before we'll actually pay the slotting. And so that part of the issue is that I would hope that with some of our new items that we're going to distribution, that we have to pay the slotting because that means we're up to distribution we want.

But the net of that could be that it could have contra revenue effect that I'm not forecasting in my guidance. So, we try to leave some room for the unattended consequences of good work on our distribution front.

Sarah Lester: Right. All right, thank you. And then also, with the water shortage in California, has that been a problem for any of your growers or could that become a problem?

Michael Mendes: You know, water is definitely always in the short list of issues of California farmers. The one thing that I would say when you look at the whole farming universe, the higher yielding agricultural commodities tend to be at the top of the food chain in their ability to get to that water supply, and also, their ability to capitalize their own operations to have pumps and their ability to access water.

And also part of the decision and the land value is based on the land's intrinsic ability to get water. So I would say if we were sitting here and maybe we are getting caught and a row crop, it would be a heightened concern. I would say it's a concern, but I would say that it's something that farmer's are aggressively trying to address.

But, I think your questions a bit prophetic because I wouldn't be surprised if we're sitting here five years from now and I have a little different answer on that. But today, I would say that's not a short-term - I don't think that's a short-term issue that would have an impact on our business today.

Sarah Lester: Okay. That's all, thank you.

Operator: Your next question comes from the line of Shawn Tesoro.

Shawn Tesoro: Hey guys, just on the breakdown of the improvement in gross margin, you talked about mix, leverage, SKU rationalization, some efficiency that I think falls into a couple of those buckets. Any way you can kind of break that down a little bit more us of the $320 million, how much came from - or at least a generalization of how much came from each bucket?

Steve Neil: You know, we're not going to go down that path Shawn. I think it's a good question, but we think each one of them will play out. I mean, our target really is over the long-term to get the margin - the gross margin up to 20% by 2011, and frankly the operating margin up to 10% in the same timeframe. So, it's going to be a combination of all of the above.

Certainly now there's as Michael I think mentioned on the call or one of the questions earlier with Ken, we're able to spend some capital that we haven't been able to spend previously under the co-op operation that enables us to drive a lot of these deficiencies. So, you'll probably see a little bit more, actually operational efficiencies on that end now. I think as we move out in 2010 and 2011, you're going to see a greater lift from just volume. The volume taking advantage of capacity and just work in the variable costs.

So, it's a combination on all the above and we really look at it on a long-term basis, so we really haven't broken those pieces out.

Shawn Tesoro: Okay, and then on the international side, any quantification in that $5 million down year-over-year of what this rationalization was?

Michael Mendes: I'll take a shot at that. I think it's more of identifying where we're going to allocate the product. So on the international side we're allocating the product more to the value-added segment of the business and less to what I would call it, more of a trading from our co-op legacy.

The SKU reductions are more in what we're looking at. For example in the Harmony acquisition we acquired quite a few SKUs and we're working very, very aggressively to call those SKUs that frankly don't have adequate volume that we can get a return with pricing. So, that's in part where we're trying to focus on efficiencies coming out of the plant.

So, when we say SKU on the international side, I think it's more the customer that values the value-added components of our business.

Shawn Tesoro: Okay, great. Thank you guys.

Michael Mendes: Thank you.

Operator: There are no further questions.

Michael Mendes: Well thank you everyone for joining us. Before we conclude, I just want to remind you of some investor events coming up. Next week we will be, on June 10, presenting at the Piper Jaffrey conference in New York, and then on July 1, we'll also be at the Longbow Securities conference which will also be in New York.

If you have any more questions about our investor events, please visit our Diamond Web site.

Thank you for joining us.

Operator: That concludes today's conference call. You may now disconnect.

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