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**Q2 FISCAL YEAR 2010**  
**EARNINGS CONFERENCE CALL**

February 26, 2010, 5:30 AM PT

Chairperson: Bob Philipps, VP Treasury & Investor  
Relations

**Bob Philipps:**

Thank you, operator, and good morning everyone. Welcome to the Diamond Foods investor conference call and webcast to review the financial results of our second quarter fiscal 2010 which ended January 31, and to discuss our planned acquisition of Kettle Foods.

Before we get started, let's cover a few housekeeping items.

- First, a printed copy of our prepared remarks will be available on our website [diamondfoods.com](http://diamondfoods.com) under the section titled "Investor Relations" followed by "Earnings Releases" within 1 hour after the call's conclusion.

- Second, we've arranged for a taped replay of this call to be available via telephone beginning about two hours after the call's conclusion until 8:30 a.m. Pacific Time on March 3, 2010. The toll-free dial-in number to access the replay is (888) 203-1112; otherwise, use (719) 457-0820. The conference ID is 864-5198.

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, our Chairman, President and Chief Executive Officer.

**Michael Mendes:**

Thanks Bob. Good morning everyone and thank you for joining us on such short notice.

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

Today we plan to spend a little less time than normal in reviewing our recent financial performance, so that we can devote more of our time to the acquisition of Kettle Foods.

We were very pleased with the results of our second quarter, with sales up 22% and (non-GAAP)

earnings up 33% as compared to the same period last year. As a reflection of this performance and our confidence in the company's ability to drive earnings growth for the balance of the year, we are also increasing our full year sales and earnings guidance on our base business, excluding the effect of the Kettle acquisition.

Steve will now review some of the highlights of the quarter.

**Steve Neil:**

Thanks, Michael. Please note that our earnings press release and 10-Q were both filed last night.

As Michael mentioned, sales growth was strong in Q2. As we noted last quarter, some of this was a result of the later fall harvest which shifted sales from our first quarter to our second quarter. The impact was most pronounced in our non-retail and in-shell businesses. On a year-to-date basis, sales are up 5% and in line with our full-year growth guidance.

- Since culinary volumes in the quarter were flat overall, the 13% decline in culinary sales reflects the planned investments we've made to deliver greater value to our customers as we benefited from lower commodity prices, and the impact from the discontinuance of two low margin club items during the fourth quarter of fiscal 2009. Excluding the discontinued items, culinary volumes grew 10%.
- Snack sales increased 17%, with Emerald up nearly 50% and Pop Secret down slightly as a result of SKU rationalization. Both brands saw significant promotional support late in the quarter as a result of the build-up to Super Bowl XLIV that helped February sales.
- Non-retail sales are running well ahead of last year on a year-to-date basis, with very strong in-shell shipments in the U.S. and internationally, along with bulk shelled shipments. Some of the latter is more related to timing, as the 2009 crop had a high proportion of amber material that was best suited to the USDA school lunch program. Typically,

the sale of this material would take place in the second half of the year.

While the 2009 walnut crop turned out to be the largest in history, it was the “off” year in terms of production. In fact, at an industry meeting last week, the handler’s coalition predicted another record crop for 2010. Consistent with this outlook, we want to make sure that our inventories are well-positioned as we move into the back half of our fiscal year.

- Gross margins were 22.0%, 60 basis points below last year’s quarter as a result of a greater mix of non-retail sales associated with the later harvest. Non-retail sales accounted for 28% of the overall sales mix this year compared to only 13% during last year’s quarter and 20% in the first fiscal quarter. Importantly, year-to-date gross margin was 23.6%, an increase of 190 basis points over last year’s period.
- SG&A included \$475,000 in one-time fees to assist us in the filing of prior period tax credits. Excluding these fees, SG&A as a percentage of

sales was 8.1%, compared to 10.6% last year. Year-to-date SG&A is 7.8% of sales versus 9.2% last year when we were incurring costs as we transitioned the operations of Pop Secret from General Mills.

- As we said during last quarter's call, we are executing the largest and most robust marketing campaign in our history. As a result, advertising spending of \$12.2 million grew \$5.9 million over last year.
- Even with a year-to-date increase of \$6.4 million in advertising investments, we still posted a healthy 25% increase in operating profits.
- Interest expense came in at \$916,000, which reflected favorable rates and a \$19 million reduction in net debt since the first quarter. We generated \$17 million in EBITDA, which allowed us to pay down \$10 million in long-term debt and achieve a quarter-end leverage ratio of 1.4x.
- The GAAP tax rate of 27.6% during the quarter included the impact of \$950,000 in prior period

R&D and Extraterritorial Income Exclusion tax credits. As noted earlier, we incurred expenses of \$475,000 to realize these filed tax credits.

- GAAP EPS was \$0.52, but excluding the effect of the tax filing fees and tax credits, non-GAAP EPS was \$0.48.

Given our strong earnings performance during the first half, we are making the following changes to our fiscal year 2010 guidance:

- We are raising snack sales guidance to a range of \$230 million to \$240 million compared to \$220 million to \$230 million previously. The midpoint of the new range suggests sales in the second half would approximate the first half, despite the strong benefit the Super Bowl promotional activities had on the first-half.
- Accordingly, we've have taken up total sales guidance to \$595 million to \$610 million, compared to \$585 million to \$605 million previously.

- On January 29, we increased our full-year EPS guidance from a range of \$1.72 to \$1.82, to a range of \$1.75 to \$1.83 (non-GAAP). Today, we are raising the lower end of our guidance which results in a range of \$1.79 to \$1.83 per share (non-GAAP). This represents growth of between 22 and 24 percent above fiscal 2009's \$1.47 per share.
- Also note that these sales and EPS guidance changes do not reflect the impact of the Kettle acquisition, which we'll talk about in a moment.

Now I'll turn the call back to Michael.

**Michael Mendes:**

Thanks, Steve.

We are very pleased to announce that we have signed a purchase agreement with Lion Capital to acquire Kettle Foods.

Kettle is an exceptional premium brand and a great complement to our snack portfolio. For over 20 years, the people at Kettle have focused on producing natural, premium snacks, and have posted an impressive record of building the business since it was founded in 1978.

As a result of this transaction, we will acquire two manufacturing plants in the U.S. and one in the U.K., as well as inventory and related intellectual property. Importantly, we will also add a talented team of highly motivated employees that will fit well within our culture.

We will fund the acquisition with a combination of cash on hand, debt and equity. While the timing of closing the transaction is subject to normal regulatory approvals, we anticipate closing by the end of our fiscal year.

We have taken a very deliberate approach towards screening potential acquisitions. We have focused on identifying premium brands with growth potential that target customer segments we currently serve, and brands that can provide solid financial

returns to our shareholders. Kettle clearly fits these criteria, and we plan to invest in the brand to assure long-term success.

Pop Secret has clearly helped benefit Emerald. In a similar fashion, we believe Kettle will increase our scale in the snack aisle by leveraging existing distribution, retailer relationships, supply chain and infrastructure.

In addition, Kettle can help accelerate our top line growth while delivering margins that are accretive to our overall business:

- Kettle has substantial room for continued growth. In the U.S., we plan to focus on expanding distribution, with emphasis on customers and channels that are strengths for Diamond. We also believe there is an opportunity to expand distribution of Kettle's "better for you" baked items in the U.S., and increase the brand's presence in the mainstream snack aisle. In the U.K., we will focus on gaining share in the single-serve segment, and look to develop new product lines that target a broader consumer demographic.

We also look to leverage the U.K. base to support further European expansion.

- With Kettle, we increase our addressable markets by \$9 billion as a result of the addition of the U.S. and U.K. potato chip categories.
- Kettle has a diverse go-to-market model that combines warehouse delivery, distributors and DSD alliances. Given the nature of the offering, we believe the combined new Diamond Foods portfolio will provide scale that better enables us to access and service snack channels that we have not effectively serviced in the past. The expanded scale of our offering has the long-term potential to open new channels for Emerald and Pop Secret, and further expand Kettle.

We are extremely pleased with the performance and trajectory of our Diamond Foods base business, but we believe this acquisition significantly expands and improves the quality and scale of our platform. As a result of this transaction, we increase our product, customer, and geographic diversity, while increasing the proportion of our total sales in the value-added

retail segment. The addition of the Kettle business provides us a brand that is distinct and well positioned in the market, with significant opportunity for growth in the future. While we project that this business will be accretive in the first year, we plan to invest in the brand and our entire retail platform to facilitate more dynamic growth in the future.

At this time, I would like to turn the call over to Steve in order that he can review the transaction in greater detail.

**Steve Neil:**

Thanks Michael.

Kettle Foods was founded in Oregon in 1978 and began making and selling chips in the U.S. in 1982, and the U.K. in 1989. Today it is an iconic, premium brand based on superior quality and taste in the two largest potato chip markets in the world. Just under 60% of its sales are in the U.S. with the balance in the U.K., while its EBITDA is more

evenly split. In both countries, Kettle is the most widely recognized brand in the premium chip segment, and its sales growth has outperformed the category. For example, Nielsen reports that the total potato chip category in the U.S. grew 9% during the 52 weeks ended January 23, while Kettle grew 21%. In the U.K., the category grew 6%, while Kettle grew 6%.

Kettle offers Diamond an attractive margin and cash flow profile.

- During the trailing twelve months ended in January, Kettle generated approximately \$260 million in sales and delivered a mid-thirties gross margin and \$62 million in EBITDA.
- During the same period, Diamond generated \$590 million in sales delivered a 25% gross margin and \$69 million in EBITDA.
- So the acquisition increases Diamond's sales by a little over 40% and almost doubles EBITDA.

For the purchase price of \$615 million, we will acquire three plants, inventory, accounts receivable and the rights to the brand. The plants are located in Salem, Oregon; Beloit, Wisconsin and Norwich, England.

To fund the transaction, we've put in place a 5-year \$600 million secured credit facility comprised of a \$200 million revolver and a \$400 million term loan. The bank syndication was led by Bank of America and Barclays Capital, and was funded on a "best efforts" basis, thereby saving us underwriting fees.

In addition, we plan an equity issuance to help fund the purchase with expected marketing and pricing next week. In the event that an equity issuance is delayed, a bridge loan has been arranged as a backstop.

As indicated in the press release, we expect Kettle to be accretive to earnings in its first year without consideration of any synergies that may be realized. The specific impact on fiscal 2010, however, is difficult to measure until we have closed the transaction.

In 2011, we anticipate making significant investments in slotting and advertising to build distribution and brand equity. In connection with the acquisition, we'll incur higher interest expenses and a greater share count. However, we still anticipate to deliver mid single digit to low double digit EPS accretion.

As a result, we expect fiscal 2011 EPS to range from \$2.25 to \$2.35.

At this time we will conclude our formal comments and open the call for questions.

## [Q&A]

**Bob Philipps:**

Thank you, operator.

Thank you for joining us. This will conclude our call.

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