
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-51439

DIAMOND FOODS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

20-2556965
(IRS Employer Identification No.)

600 Montgomery Street, 17th Floor San Francisco, California
(Address of Principal Executive Offices)

94111-2702
(Zip Code)

415-912-3180
(Telephone No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes No

Number of shares of common stock outstanding as of January 31, 2011: 21,973,478

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The statements contained in this Quarterly Report regarding our future financial and operating performance and results, business strategy, market prices, future commodity prices, plans and forecasts, and other statements that are not historical facts are forward-looking statements. We use the words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “seek,” and other similar expressions to identify forward-looking statements; many of which discuss our future expectations, contain projections of our results of operations or financial condition or state other “forward-looking” information. We have based these forward-looking statements on our assumptions, expectations and projections about future events only as of the date of this Quarterly Report.

These forward-looking statements also involve many risks and uncertainties that could cause actual results to differ from our expectations in material ways. Please refer to the risks and uncertainties discussed in the section titled “Risk Factors.” You also should carefully consider other cautionary statements elsewhere in this Quarterly Report and in other documents we file from time to time with the Securities and Exchange Commission (“SEC”), including our most recent Annual Report on Form 10-K. We do not undertake any obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

DIAMOND FOODS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share information)
(Unaudited)

	<u>January 31,</u> <u>2011</u>	<u>July 31,</u> <u>2010</u>	<u>January 31,</u> <u>2010</u>
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 2,276	\$ 5,642	\$ 11,962
Trade receivables, net	80,590	65,553	54,652
Inventories	215,697	143,405	149,053
Deferred income taxes	10,497	10,497	12,908
Prepaid income taxes	3,087	9,225	1,661
Prepaid expenses and other current assets	<u>11,557</u>	<u>5,767</u>	<u>2,819</u>
Total current assets	323,704	240,089	233,055
Restricted cash	21,215	—	—
Property, plant and equipment, net	117,022	117,816	50,916
Deferred income taxes	12,254	13,625	6,269
Goodwill	404,078	396,788	75,243
Other intangible assets, net	451,745	449,018	96,951
Other long-term assets	<u>7,510</u>	<u>8,536</u>	<u>3,700</u>
Total assets	<u>\$1,337,528</u>	<u>\$1,225,872</u>	<u>\$ 466,134</u>
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current portion of long-term debt	\$ 41,700	\$ 40,000	\$ 15,872
Accounts payable and accrued liabilities	109,868	92,166	79,171
Payable to growers	<u>83,553</u>	<u>35,755</u>	<u>76,976</u>
Total current liabilities	235,121	167,921	172,019
Long-term obligations	507,200	516,100	81,650
Deferred income taxes	147,317	144,755	3,060
Other liabilities	19,229	17,153	12,240
Stockholders' equity:			
Preferred stock, \$0.001 par value; Authorized: 5,000,000 shares; no shares issued or outstanding	—	—	—
Common stock, \$0.001 par value; Authorized: 100,000,000 shares; 22,234,642, 22,121,534 and 16,857,118 shares issued and 21,973,478, 21,891,928 and 16,629,076 shares outstanding at January 31, 2011, July 31, 2010 and January 31, 2010, respectively	22	22	17
Treasury stock, at cost: 261,164, 229,606 and 228,042 shares held at January 31, 2011, July 31, 2010 and January 31, 2010, respectively	(6,392)	(5,050)	(4,986)
Additional paid-in capital	312,505	307,032	124,894
Accumulated other comprehensive income (loss)	11,759	(869)	(1,067)
Retained earnings	<u>110,767</u>	<u>78,808</u>	<u>78,307</u>
Total stockholders' equity	428,661	379,943	197,165
Total liabilities and stockholders' equity	<u>\$1,337,528</u>	<u>\$1,225,872</u>	<u>\$ 466,134</u>

See notes to condensed consolidated financial statements.

DIAMOND FOODS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share information)
(Unaudited)

	Three Months		Six Months	
	Ended January 31,		Ended January 31,	
	2011	2010	2011	2010
Net sales	\$257,592	\$184,169	\$510,158	\$364,810
Cost of sales	186,736	143,591	375,706	278,741
Gross profit	70,856	40,578	134,452	86,069
Operating expenses:				
Selling, general and administrative	24,011	15,338	47,114	28,835
Advertising	9,968	12,150	22,437	18,442
Acquisition and integration related expenses	937	—	1,436	—
Total operating expenses	34,916	27,488	70,987	47,277
Income from operations	35,940	13,090	63,465	38,792
Interest expense, net	5,992	916	12,109	2,164
Income before income taxes	29,948	12,174	51,356	36,628
Income taxes	10,228	3,360	17,422	12,884
Net income	<u>\$ 19,720</u>	<u>\$ 8,814</u>	<u>\$ 33,934</u>	<u>\$ 23,744</u>
Earnings per share:				
Basic	\$ 0.90	\$ 0.53	\$ 1.55	\$ 1.43
Diluted	\$ 0.87	\$ 0.52	\$ 1.51	\$ 1.39
Shares used to compute earnings per share:				
Basic	21,565	16,280	21,519	16,280
Diluted	22,221	16,764	22,031	16,735
Dividends declared per share	\$ 0.045	\$ 0.045	\$ 0.090	\$ 0.090

See notes to condensed consolidated financial statements.

DIAMOND FOODS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended January 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 33,934	\$ 23,744
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,978	5,432
Deferred income taxes	2,102	2,039
Excess tax benefit from stock option transactions	(1,367)	(302)
Stock-based compensation	3,516	1,401
Other, net	211	253
Changes in assets and liabilities:		
Trade receivables	(15,037)	(21,160)
Inventories	(72,292)	(64,026)
Prepaid expenses, income taxes and other current assets	348	(927)
Accounts payable and accrued liabilities	19,495	15,979
Payable to growers	47,798	47,827
Other, net	1,055	254
Net cash provided by operating activities	<u>34,741</u>	<u>10,514</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net proceeds from sale of property, plant and equipment	9	159
Purchase of property, plant and equipment	(9,251)	(4,343)
Restricted cash	(21,215)	—
Acquisition of Pop Secret	—	(62)
Net cash used in investing activities	<u>(30,457)</u>	<u>(4,246)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of revolving line of credit under the Secured Credit Facility	(8,400)	—
Proceeds from issuance of long-term debt	21,200	—
Payment of long-term debt and notes payable	(20,063)	(17,558)
Dividends paid	(1,977)	(1,496)
Excess tax benefit from stock option transactions	1,367	302
Other, net	203	(356)
Net cash used in financing activities	<u>(7,670)</u>	<u>(19,108)</u>
Effect of exchange rate changes on cash	20	—
Net decrease in cash and cash equivalents	(3,366)	(12,840)
Cash and cash equivalents:		
Beginning of period	<u>5,642</u>	<u>24,802</u>
End of period	<u>\$ 2,276</u>	<u>\$ 11,962</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	\$ 11,146	\$ 1,523
Income taxes	\$ 1,511	\$ 7,963
Non-cash investing activity:		
Accrued capital expenditures	\$ 693	\$ 160

See notes to condensed consolidated financial statements.

DIAMOND FOODS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three and six months ended January 31, 2011 and 2010
(In thousands, except share and per share information, unaudited)

(1) Organization and Basis of Presentation

Diamond Foods, Inc. (the “Company” or “Diamond”) is an innovative packaged food company focused on building, acquiring and energizing brands. Diamond specializes in processing, marketing and distributing snack products and culinary, in-shell and ingredient nuts. In 2004, Diamond complemented its strong heritage in the culinary nut market under the Diamond of California® brand by launching a full line of snack nuts under the Emerald® brand. In September 2008, Diamond acquired the Pop Secret® brand of microwave popcorn products, which provided the Company with increased scale in the snack market, significant supply chain economies of scale and cross promotional opportunities with its existing brands. In March 2010, Diamond acquired Kettle Foods, a leading premium potato chip company in the two largest potato chip markets in the world, the United States and United Kingdom, which added the complementary premium brand Kettle to Diamond’s existing portfolio of leading brands in the snack industry. In general, Diamond sells directly to retailers, particularly large national grocery store and drug store chains, and indirectly through wholesale distributors to independent and small regional retail grocery store chains and convenience stores. Diamond also sells its products to mass merchandisers, club stores, convenience stores and through other retail channels. Sales to the Company’s largest customer accounted for approximately 15.4% and 15.7% of total net sales for the three and six months ended January 31, 2011 and 15.2% and 15.6% of total net sales for the three and six months ended January 31, 2010.

The accompanying unaudited condensed consolidated financial statements of Diamond have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required for annual financial statements. The accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements at and for the year ended July 31, 2010 and, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company’s financial condition at January 31, 2011, the results of the Company’s operations for the three and six months ended January 31, 2011 and 2010, and cash flows for the six months ended January 31, 2011 and 2010. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s 2010 Annual Report on Form 10-K. Operating results for the three and six months ended January 31, 2011 are not necessarily indicative of the results that may be expected for the year ending July 31, 2011.

The accompanying unaudited condensed consolidated financial statements as of January 31, 2011 included a \$12.1 million adjustment to accumulated other comprehensive income which represents the effect of the foreign currency translation on net intangible assets acquired in the Kettle Foods acquisition. At July 31, 2010, the adjustment to accumulated other comprehensive income would have been \$7.4 million. Total comprehensive income was \$32,001 and \$46,562 for the three and six months ended January 31, 2011 and \$8,814 and \$23,973 for the three and six months ended January 31, 2010.

Certain prior period amounts have been reclassified to conform to the current period presentation.

(2) Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2010-29, “*Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations.*” This guidance was issued to clarify that pro forma disclosures should be presented as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The disclosures should also be accompanied by a narrative description of the nature and amount of material, nonrecurring pro forma adjustments. This new guidance is effective prospectively for business combinations consummated on or after the annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The Company does not believe that the adoption of this guidance will have a material impact on its consolidated financial statements.

(3) Fair Value Measurements

The fair value of certain financial instruments, including cash and cash equivalents, trade receivables, accounts payable and accrued liabilities, approximate the amounts recorded in the balance sheet because of the relatively short term nature of these financial instruments. The fair value of notes payable and long-term obligations at the end of each fiscal period approximates the amounts

recorded in the balance sheet based on information available to Diamond with respect to current interest rates and terms for similar financial instruments.

The Company transacts business in foreign currencies and has international sales denominated in foreign currencies, subjecting the Company to foreign currency risk. The Company may enter into foreign currency option contracts, generally with monthly maturities over twelve months or less, to reduce the volatility of cash flows primarily related to forecasted revenue denominated in certain foreign currencies. The Company does not use foreign currency contracts for speculative or trading purposes. On the date a foreign currency option contract is entered into, the Company designates the contract as a hedge, for a forecasted transaction, of the variability of cash flows to be received (“cash flow hedge”). The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges to anticipated transactions. The Company also formally assesses, both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. Effective changes in derivative contracts designated and qualifying as cash flow hedges of forecasted revenue are reported in other comprehensive income. These gains and losses are reclassified into interest income or expense, as a component of revenue, in the same period as the hedged revenue is recognized. The Company includes time value in the assessment of effectiveness of the foreign currency derivatives. The ineffective portion of the hedge is recorded in interest expense or income. Hedge ineffectiveness recorded for the three and six months ended January 31, 2011 for foreign currency derivatives are immaterial. The maximum length of time over which the Company is hedging its exposure to the variability in future cash flows associated with forecasted foreign currency transactions is less than twelve months.

In the three months ended July 31, 2010, the Company entered into three interest rate swap agreements in accordance with Company policy to mitigate the impact of LIBOR-based interest expense fluctuations on Company profitability. These swap agreements, with a total hedged notional amount of \$100 million were entered into to hedge future interest payments associated with a portion of the Company’s variable rate bank debt. The Company has designated these swaps as hedges of future cash flows associated with its variable rate debt. All effective changes in the fair value of the designated swaps are recorded in other comprehensive income (loss) and are released to interest income or expense as the underlying transaction occurs. Ineffective changes, if any, are recognized in interest income or expense immediately. For the three and six months ended January 31, 2011, the Company recognized other comprehensive income of \$318 and \$4 based on the change in fair value of the swap agreements; no hedge ineffectiveness for these swap agreements was recognized in interest income or expense over the same period.

The fair values of the Company’s derivative instruments as of January 31, 2011 and 2010 were as follows:

Liability Derivatives	Balance Sheet Location	Fair Value		
		1/31/11	7/31/10	1/31/10
Derivatives designated as hedging instruments under ASC 815:				
Interest rate contracts	Interest payable	\$ —	\$ (2)	\$ —
Interest rate contracts	Other current liabilities	(580)	(666)	—
Interest rate contracts	Other non-current liabilities	(83)	—	—
Cash flow hedges	Accounts payable and accrued liabilities	(105)	(12)	—
Total derivatives designated as hedging instruments under ASC 815		\$ (768)	\$ (680)	\$ —
Derivatives not designated as hedging instruments under ASC 815:				
Interest rate contracts	Accrued interest	\$ —	\$ —	\$ (6)
Interest rate contracts	Other current liabilities	—	—	(418)
Cash flow hedges	Accounts payable and accrued liabilities	(41)	—	—
Total derivatives not designated as hedging instrument under ASC 815		\$ (41)	\$ —	\$ (424)
Total derivatives		\$ (809)	\$ (680)	\$ (424)

The effect of the Company’s derivative instruments on the Consolidated Statements of Operations for the three months ended January 31, 2011 and 2010 is summarized below:

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Loss Recognized in Income on Derivative (Ineffective Portion)	Amount of Loss Recognized in Income on Derivative (Ineffective Portion)	
	1/31/11	1/31/10		1/31/11	1/31/10		1/31/11	1/31/10
Interest rate contracts	\$ 137	\$ —	Interest expense	\$ (181)	\$ —	Interest expense	\$ —	\$ —
Cash flow hedges	(47)	—	Net sales	(4)	—	Net sales	—	—
Total	\$ 90	\$ —		\$ (185)	\$ —		\$ —	\$ —

Derivatives Not Designated as Hedging Instruments under ASC 815	Location of Loss Recognized in Income on Derivative	Amount of Loss Recognized in Income on Derivative	
		1/31/11	1/31/10
Interest rate contracts	Interest expense	\$ —	\$ (164)
Cash flow hedges	Interest expense	(31)	—
Total		\$ (31)	\$ (164)

The effect of the Company's derivative instruments on the Consolidated Statements of Operations for the six months ended January 31, 2011 and 2010 is summarized below:

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Loss Recognized in Income on Derivative (Ineffective Portion)	Amount of Loss Recognized in Income on Derivative (Ineffective Portion)	
	1/31/11	1/31/10		1/31/11	1/31/10		1/31/11	1/31/10
Interest rate contracts	\$ (353)	\$ 240	Interest expense	\$ (356)	\$ —	Interest expense	\$ —	\$ —
Cash flow hedges	(96)	—	Net sales	(4)	—	Net sales	—	—
Total	\$ (449)	\$ 240		\$ (360)	\$ —		\$ —	\$ —

Derivatives Not Designated as Hedging Instruments under ASC 815	Location of Loss Recognized in Income on Derivative	Amount of Loss Recognized in Income on Derivative	
		1/31/11	1/31/10
Interest rate contracts	Interest expense	\$ —	\$ (433)
Cash flow hedges	Interest expense	(75)	—
Total		\$ (75)	\$ (433)

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company's cash equivalents measured at fair value on a recurring basis was \$586 as of July 31, 2010. There were no cash equivalents as of January 31, 2011 and 2010. Diamond used level 1, quoted prices in active markets for identical assets, to value the cash equivalents.

The Company's derivative liabilities measured at fair value on a recurring basis were \$809, \$680 and \$424 as of January 31, 2011, July 31, 2010 and January 31, 2010, respectively. The Company has elected to use the income approach to value the derivative liabilities, using observable Level 2 market expectations at the measurement date and standard valuation techniques to convert future amounts to a single present amount assuming that participants are motivated, but not compelled to transact. Level 2 inputs for the valuations are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts on LIBOR for the first two years) and inputs other than quoted prices that are observable for the asset or liability (specifically LIBOR cash and swap rates). Mid-market pricing is used as a practical expedient for fair value measurements. Under Accounting Standards Codification ("ASC) 820, "Fair Value Measurements and Disclosures," the fair value measurement of an asset or liability must reflect the nonperformance risk of the entity and the counterparty. Therefore, the impact of the counterparty's creditworthiness when in an asset position and the Company's creditworthiness when in a liability position has also been factored into the fair value measurement of the derivative instruments and did not have a material impact on the fair value of the derivative instruments.

(4) Stock Plan Information

In March 2010, the Company issued and sold 5,175,000 shares of its common stock for \$37.00 per share. After deducting the underwriting discount and other related expenses, the Company received total net proceeds from the sale of its common stock of approximately \$179.7 million. The proceeds from the equity offering were used to fund a portion of the purchase price for the Kettle Foods acquisition.

The Company uses a broad based equity incentive plan to help align employees and director incentives with stockholders' interests, and accounts for stock-based compensation in accordance with ASC 718, "Compensation — Stock Compensation." The fair value of all stock options granted is recognized as an expense in the Company's statements of operations, typically over the related vesting period of the options. The guidance requires use of fair value computed at the date of grant to measure share-based awards.

The fair value of restricted stock awards is recognized as stock-based compensation expense over the vesting period. Stock options may be granted to officers, employees and directors.

Stock Option Awards: The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option valuation model. Expected stock price volatilities were estimated based on the Company's implied historical volatility. The expected term of options granted and forfeiture rates were based on assumptions and historical data to the extent it is available. The risk-free rates were based on U.S. Treasury yields in effect at the time of the grant. For purposes of this valuation model, dividends are based on the historical rate. Assumptions used in the Black-Scholes model are presented below:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2011	2010	2011	2010
Average expected life, in years	6	6	6	6
Expected volatility	37.00%	46.00%	37.00%	46.00%
Risk-free interest rate	2.12%	3.56%	1.93%	3.50%
Dividend rate	0.36%	0.55%	0.40%	0.57%

The following table summarizes stock option activity during the six months ended January 31, 2011:

	Number of Shares (in thousands)	Weighted average exercise price per share	Weighted average remaining contractual life (in years)	Aggregate intrinsic value (in thousands)
Outstanding at July 31, 2010	1,452	\$ 21.11		
Granted	350	40.66		
Exercised	(35)	16.85		
Cancelled	(12)	33.36		
Outstanding at January 31, 2011	1,755	25.01	6.7	\$ 43,467
Exercisable at January 31, 2011	1,204	18.46	5.4	37,694

The weighted average fair value per share of stock options granted during the three and six months ended January 31, 2011 was \$20.30 and \$14.94, respectively. The weighted average fair value per share of stock options granted during the six months ended January 31, 2010 was \$15.17 (there were no stock options granted during the three months ended January 31, 2010). The fair value per share of options vested during the three and six months ended January 31, 2011 was \$11.62 and \$9.03, respectively. The fair value per share of options vested during the comparable periods in 2010 was \$6.43 and \$7.14, respectively.

Changes in the Company's nonvested stock options during the six months ended January 31, 2011 are summarized as follows:

	Number of Shares (in thousands)	Weighted average grant date fair value per share
Nonvested at July 31, 2010	234	\$ 15.28
Granted	350	14.94
Vested	(24)	9.03
Cancelled	(9)	17.93
Nonvested at January 31, 2011	551	15.30

As of January 31, 2011, there was approximately \$6.9 million of total unrecognized compensation expense related to nonvested stock options, which is expected to be recognized over a weighted average period of 2.1 years.

Restricted Stock Awards: As of January 31, 2011, there were 407,370 shares of restricted stock outstanding. Restricted stock activity during the six months ended January 31, 2011 is summarized as follows:

	Number of Shares (in thousands)	Weighted average grant date fair value per share
Outstanding at July 31, 2010	408	\$ 26.78
Granted	88	41.52
Vested	(78)	21.13
Cancelled	(11)	36.68
Outstanding at January 31, 2011	<u>407</u>	30.83

The weighted average fair value per share of restricted stock granted during the three and six months ended January 31, 2011 was \$52.80 and \$41.52, respectively. The weighted average fair value per share of restricted stock granted during the three and six months ended January 31, 2010 was \$30.58 and \$28.62, respectively. The fair value per share of restricted stock vested during the three and six months ended January 31, 2011 was \$25.08 and \$21.13, respectively. The fair value per share of restricted stock vested during the three and six months ended January 31, 2010 was \$23.02 and \$21.06, respectively.

As of January 31, 2011, there was \$10.1 million of unrecognized compensation expense related to nonvested restricted stock awards, which is expected to be recognized over a weighted average period of 2.5 years.

(5) Earnings Per Share

ASC 260-10, "Earnings Per Share" impacted the determination and reporting of earnings per share by requiring the inclusion of restricted stock as participating securities, since they have the right to share in dividends, if declared, equally with common shareholders. Participating securities are allocated a proportional share of net income determined by dividing total weighted average participating securities by the sum of total weighted average common shares and participating securities ("the two-class method"). Including these shares in the Company's earnings per share calculation during periods of net income has the effect of diluting both basic and diluted earnings per share.

The computations for basic and diluted earnings per share are as follows:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2011	2010	2011	2010
Numerator:				
Net income	\$ 19,720	\$ 8,814	\$ 33,934	\$ 23,744
Less: income allocated to participating securities	<u>(367)</u>	<u>(184)</u>	<u>(630)</u>	<u>(487)</u>
Income attributable to common shareholders — basic	19,353	8,630	33,304	23,257
Add: undistributed income attributable to participating securities	350	169	612	456
Less: undistributed income reallocated to participating securities	<u>(339)</u>	<u>(164)</u>	<u>(598)</u>	<u>(444)</u>
Income attributable to common shareholders — diluted	<u>\$ 19,364</u>	<u>\$ 8,635</u>	<u>\$ 33,318</u>	<u>\$ 23,269</u>
Denominator:				
Weighted average shares outstanding — basic	21,565	16,280	21,519	16,280
Dilutive shares — stock options	<u>656</u>	<u>484</u>	<u>512</u>	<u>455</u>
Weighted average shares outstanding — diluted	<u>22,221</u>	<u>16,764</u>	<u>22,031</u>	<u>16,735</u>
Income per share attributable to common shareholders (1):				
Basic	\$ 0.90	\$ 0.53	\$ 1.55	\$ 1.43
Diluted	\$ 0.87	\$ 0.52	\$ 1.51	\$ 1.39

(1) Computations may reflect rounding adjustments.

Options to purchase 3,000 shares of common stock were not included in the computation of diluted earnings per share because their exercise prices were greater than the average market price of Diamond's common stock of \$49.78 and \$45.98 for the three and

six months ended January 31, 2011, and therefore their effect would be antidilutive. Options to purchase 10,000 shares of common stock were not included in the computation of diluted earnings per share because their exercise prices were greater than the average market price of Diamond's common stock of \$31.65 for the six months ended January 31, 2010, and therefore their effect would be antidilutive. There were no options excluded during the three months ended January 31, 2010.

(6) Acquisition of Kettle Foods

In March 2010, Diamond completed its acquisition of Kettle Foods for a purchase price of approximately \$616 million in cash. Kettle Foods is a leading premium potato chip company in the two largest potato chip markets in the world (the United States and the United Kingdom), and adds a complementary premium brand to Diamond's existing portfolio of leading brands in the snack industry. The Company believes the acquisition of Kettle Foods will expand Diamond's presence in the attractive snack market and enables Diamond to enter new channels and geographies by leveraging its combined marketing and distribution capabilities. The acquisition was accounted for under the purchase method of accounting in accordance with ASC 805, "Business Combinations."

The total purchase price has been preliminarily allocated to the estimated fair values of assets acquired and liabilities assumed as follows:

Accounts receivable	\$ 29,188
Inventory	12,526
Deferred tax asset	2,119
Prepaid expenses and other assets	3,617
Property, plant and equipment	66,289
Brand intangibles	235,000
Customer relationships	120,000
Goodwill	321,545
Assumed liabilities	(39,211)
Deferred tax liabilities	(134,851)
Purchase price	<u>\$ 616,222</u>

The Company's purchase price allocation is subject to tax and accrual adjustments that are expected to be completed by the three months ending April 30, 2011. Adjustments may impact the total purchase price, deferred taxes and goodwill. The preliminary allocation of the purchase price included in the current period balance sheet is based on management's best estimates of fair value at this time and is subject to tax and other adjustments.

Goodwill is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. These benefits include workforce additions, expansion opportunities and increased presence in the overall snack category.

Goodwill associated with the Kettle Foods acquisition is not amortized and is not deductible for tax purposes.

Customer relationships of Kettle Foods will be amortized on a straight-line basis over an estimated life of 20 years. Brand intangibles relate to the "Kettle Foods" brand name, which has an indefinite life, and therefore is not amortizable.

(7) Balance Sheet Items

Inventories consisted of the following:

	<u>January 31,</u> <u>2011</u>	<u>July 31,</u> <u>2010</u>	<u>January 31,</u> <u>2010</u>
Raw materials and supplies	\$ 137,336	\$ 64,660	\$ 86,864
Work in process	22,186	23,768	17,452
Finished goods	56,175	54,977	44,737
Total	<u>\$ 215,697</u>	<u>\$143,405</u>	<u>\$ 149,053</u>

In the three months ended January 31, 2011, the Company revised its estimate for expected walnut costs which resulted in a pre-tax increase in cost of sales of approximately \$1.2 million for walnut sales recognized in the first three months of fiscal year 2011. In the three months ended January 31, 2010, the Company revised its estimate for expected walnut costs which resulted in a pre-tax decrease in cost of sales of approximately \$2.6 million for walnut sales recognized in the first three months of fiscal year 2010.

Accounts payable and accrued liabilities consisted of the following:

	<u>January 31, 2011</u>	<u>July 31, 2010</u>	<u>January 31, 2010</u>
Accounts payable	\$ 51,514	\$42,784	\$ 45,874
Accrued promotion	28,832	22,787	18,727
Accrued salaries and benefits	11,447	17,587	8,238
Income taxes payable	5,884	—	4,225
Other	12,191	9,008	2,107
Total	<u>\$ 109,868</u>	<u>\$92,166</u>	<u>\$ 79,171</u>

(8) Intangible Assets and Goodwill

The changes in the carrying amount of goodwill are as follows:

Balance as of July 31, 2010	\$396,788
Acquisitions/other activities	—
Translation adjustments	7,290
Balance as of January 31, 2011	<u>\$404,078</u>

Other intangible assets consisted of the following:

	<u>January 31, 2011</u>	<u>July 31, 2010</u>	<u>January 31, 2010</u>
Brand intangibles (not subject to amortization)	\$ 299,963	\$297,500	\$ 62,500
Intangible assets subject to amortization:			
Customer contracts and related relationships	<u>161,678</u>	<u>157,300</u>	<u>37,300</u>
Total other intangible assets, gross	<u>461,641</u>	<u>454,800</u>	<u>99,800</u>
Less accumulated amortization on intangible assets:			
Customer contracts and related relationships	<u>(9,896)</u>	<u>(5,782)</u>	<u>(2,849)</u>
Total other intangible assets, net	<u>\$ 451,745</u>	<u>\$449,018</u>	<u>\$ 96,951</u>

Identifiable intangible asset amortization expense annually for each of the five succeeding years will amount to approximately \$8,084 and will approximate \$4,042 for the remainder of fiscal year 2011.

(9) Credit Facilities and Long-Term Obligations

In February 2010, Diamond entered into an agreement to replace an existing credit facility with a new five-year \$600 million secured credit facility (the "Secured Credit Facility") with a syndicate of lenders. The Company used the borrowings under the Secured Credit Facility to fund a portion of the Kettle Foods acquisition and to fund ongoing operations.

Diamond's Secured Credit Facility consists of a \$200 million revolving credit facility, of which \$157.7 million was outstanding as of January 31, 2011, and a \$400 million term loan facility, of which \$370 million was outstanding as of January 31, 2011. Scheduled principal payments on the term loan are \$40 million for fiscal year 2011 and each of the succeeding three years (due quarterly), and \$10 million for each of the first two quarters in fiscal year 2015, with the remaining principal balance and any outstanding loans under the revolving credit facility to be repaid on the fifth anniversary of initial funding. Borrowings under the Secured Credit Facility will bear interest, at Diamond's option, at either the agent's base rate or the LIBOR rate, plus a margin for LIBOR loans ranging from 2.25% to 3.50%, based on the consolidated leverage ratio which is defined as the ratio of total debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"). For the three and six months ended January 31, 2011, the blended interest rate was 4.74%

and 4.71%, respectively. Substantially all of the Company's tangible and intangible assets are considered collateral security under the Secured Credit Facility.

The Secured Credit Facility also provides for customary affirmative and negative covenants, including a debt to EBITDA ratio and minimum fixed charge coverage ratio. As of January 31, 2011, the Company was in compliance with all applicable financial covenants under the Secured Credit Facility.

On December 20, 2010, Kettle Foods obtained, and Diamond guaranteed, a 10-year fixed rate loan (the "Guaranteed Loan") in the principal amount of \$21.2 million. The principal and interest payments are due monthly throughout the term of the loan. The Guaranteed Loan will be used to purchase equipment for the Beloit, Wisconsin plant expansion. Borrowed funds have been placed in an interest-bearing escrow account and will be made available as expenditures are approved for reimbursement. As the cash will be used to purchase non-current assets, such restricted cash has been classified as non-current on the balance sheet. The Guaranteed Loan also provides for customary affirmative and negative covenants, which are similar to the covenants under the Secured Credit Facility.

(10) Retirement Plans

Diamond provides retiree medical benefits and sponsors two defined benefit pension plans. One plan is a qualified plan covering all bargaining unit employees and the other is a nonqualified plan for certain salaried employees. The amounts shown for pension benefits are combined amounts for all plans. Diamond uses a July 31 measurement date for its plans. Plan assets are held in trust and primarily include mutual funds and money market accounts. Any employee who joined the Company after January 15, 1999 is not entitled to retiree medical benefits.

Components of net periodic benefit cost (income) were as follows:

	Pension Benefits				Other Benefits			
	Three Months Ended		Six Months Ended		Three Months Ended		Six Months Ended	
	January 31,		January 31,		January 31,		January 31,	
	2011	2010	2011	2010	2011	2010	2011	2010
Service cost	\$ 20	\$ 162	\$ 40	\$ 323	\$ 16	\$ 15	\$ 32	\$ 31
Interest cost	316	299	632	598	27	34	54	67
Expected return on plan assets	(258)	(238)	(516)	(476)	—	—	—	—
Amortization of prior service cost	3	7	7	13	—	—	—	—
Amortization of net loss / (gain)	166	127	331	255	(199)	(206)	(398)	(412)
Net periodic benefit cost / (income)	<u>\$ 247</u>	<u>\$ 357</u>	<u>\$ 494</u>	<u>\$ 713</u>	<u>\$ (156)</u>	<u>\$ (157)</u>	<u>\$ (312)</u>	<u>\$ (314)</u>

The Company recognized defined contribution plan expenses of \$248 and \$399 for the three and six months ended January 31, 2011 and \$120 and \$281 for the three and six months ended January 31, 2010.

(11) Contingencies

The Company has various legal actions in the ordinary course of business. All such matters are subject to many uncertainties that make their ultimate outcomes unpredictable. However, in the opinion of management, resolution of all legal matters is not expected to have a material adverse effect on the Company's financial condition, operating results or cash flows.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are an innovative packaged food company focused on building, acquiring and energizing brands. Our company was founded in 1912 and has a proven track record of growth, which is reflected in the growth of our revenues from approximately \$200 million in fiscal year 2000 to approximately \$680 million in fiscal year 2010. We specialize in processing, marketing and distributing snack products and culinary, in-shell and ingredient nuts. In 2004, we complemented our strong heritage in the culinary nut market under the Diamond of California® brand by launching a full line of snack nuts under the Emerald® brand. In September 2008, we acquired the Pop Secret® brand of microwave popcorn products, which provided us with increased scale in the snack market, significant supply chain economies of scale and cross promotional opportunities with our existing brands. In March 2010, we acquired Kettle Foods, a leading premium potato chip company in the two largest potato chip markets in the world, the United States and United Kingdom,

which added the complementary premium brand Kettle to our existing portfolio of leading brands in the snack industry. In general, we sell directly to retailers, particularly large national grocery store and drug store chains, and indirectly through wholesale distributors to independent and small regional retail grocery store chains and convenience stores. We also sell our products to mass merchandisers, club stores, convenience stores and through other retail channels.

Our business is seasonal. For example, in 2010 and 2009, we recognized 54% and 61% of our net sales for the full fiscal year in the first six months of the year. Demand for nut products, particularly in-shell nuts and to a lesser extent culinary nuts, is highest during the months of October, November and December. We receive walnuts during the period from September to November and process them throughout the year. As a result of this seasonality, our personnel and working capital requirements and walnut inventories peak during the last quarter of the calendar year. This seasonality also impacts capacity utilization at our facilities, which routinely operate at capacity for the last four months of the calendar year. Generally, we receive and pay for approximately 50% of the corn for popcorn in November, and approximately 50% in April, and we receive and pay for potatoes for potato chips ratably throughout the year. Accordingly, the working capital requirements of our popcorn and potato chip product lines is less seasonal than that of the tree nut product lines.

Results of Operations

Net sales were \$257.6 million and \$510.2 million for the three and six months ended January 31, 2011. Net sales were \$184.2 million and \$364.8 million for the three and six months ended January 31, 2010. For the three and six months ended January 31, 2011, the increase in net sales was primarily due to strong snack sales (including Kettle Foods).

Net sales by channel (in thousands):

	Three Months Ended January 31,		% Change from 2010 to 2011	Six Months Ended January 31,		% Change from 2010 to 2011
	2011	2010		2011	2010	
Retail (1)	\$215,642	\$132,248	63.1%	\$443,393	\$276,404	60.4%
International Non-Retail	36,793	36,039	2.1%	57,808	59,158	-2.3%
North American Ingredient/Food Service and Other	5,157	15,882	-67.5%	8,957	29,248	-69.4%
Total	<u>\$257,592</u>	<u>\$184,169</u>	<u>39.9%</u>	<u>\$510,158</u>	<u>\$364,810</u>	<u>39.8%</u>

(1) Retail represents sales of our culinary, snack and in-shell products.

For the three and six months ended January 31, 2011, the increase in retail sales resulted from higher sales of snack products (including Kettle Foods), which increased by 133.3% and 131.6% for those periods, respectively. North American ingredient/food service and other sales for the six months ended January 31, 2011 decreased primarily because the United States Department of Agriculture school lunch program was not offered in fiscal year 2011.

Sales to our largest customer represented approximately 15.4% and 15.7% of total net sales for the three and six months ended January 31, 2011 and 15.2% and 15.6% of total net sales for the three and six months ended January 31, 2010.

Gross profit. Gross profit as a percentage of net sales was 27.5% and 26.4% for the three and six months ended January 31, 2011 and was 22.0% and 23.6% for the three and six months ended January 31, 2010. Gross profit as a percentage of net sales increased mainly due to favorable product mix and the result of cost efficiency initiatives. In the three months ended January 31, 2011, we revised our estimate for expected walnut costs which resulted in a pre-tax increase in cost of sales of approximately \$1.2 million for walnut sales recognized in the first three months of fiscal year 2011. In the three months ended January 31, 2010, we revised our estimate for expected walnut costs which resulted in a pre-tax decrease in cost of sales of approximately \$2.6 million for walnut sales recognized in the first three months of fiscal year 2010.

Selling, general and administrative. Selling, general and administrative expenses consist principally of salaries and benefits for sales and administrative personnel, brokerage, professional services, travel, non-manufacturing depreciation and facility costs. Selling, general and administrative expenses were \$24.0 million and \$47.1 million for the three and six months ended January 31, 2011 and \$15.3 million and \$28.8 million for the three and six months ended January 31, 2010. Selling, general and administrative expenses as a percentage of net sales were 9.3% and 9.2% for the three and six months ended January 31, 2011 and 8.3% and 7.9% for the three and

six months ended January 31, 2010. The increase was primarily due to the addition of Kettle Foods, including the associated intangible amortization for customer relationships.

Acquisition and integration related expenses. Integration related expenses associated with Kettle Foods were \$0.9 million and \$1.4 million for the three and six months ended January 31, 2011.

Advertising. Advertising expenses were \$10.0 million and \$22.4 million for the three and six months ended January 31, 2011 and \$12.2 million and \$18.4 million for the three and six months ended January 31, 2010. Advertising expenses as a percentage of net sales were 3.9% and 4.4% for the three and six months ended January 31, 2011 and 6.6% and 5.1% for the three and six months ended January 31, 2010. Advertising expenses for the three months ended January 31, 2010 included the production costs associated with four television commercials and the sponsorship of a college bowl game, which were not incurred in the current fiscal year. For the six months ended January 31, 2011, the increase in advertising, which we expect to continue throughout the fiscal year, was primarily due to increased media spending associated with the snack brands and incremental Kettle Foods brand support.

Interest expense, net. Net interest expense was \$6.0 million and \$12.1 million for the three and six months ended January 31, 2011 and \$0.9 million and \$2.2 million for the three and six months ended January 31, 2010. Net interest expense as a percentage of net sales was 2.3% and 2.4% for the three and six months ended January 31, 2011 and 0.5% and 0.6% for the three and six months ended January 31, 2010. The increase was primarily attributable to the borrowings used to fund the Kettle Foods acquisition.

Income taxes. The effective tax rate for the three and six months ended January 31, 2011 was approximately 34.2% and 33.9%. The effective tax rate for the three and six months ended January 31, 2010 was approximately 27.6% and 35.2%. The lower effective tax rate for the three months ended January 31, 2010 was primarily due to the recording of discrete tax items that resulted from filings for federal and state tax credits during the quarter. The lower effective tax rate for the six months ended January 31, 2011 primarily reflects the influence from certain tax rate jurisdictions where we have Kettle Foods operations. Income tax expense for the last six months of fiscal year 2011 is expected to be approximately 32 — 34% of pre-tax income before the impact of any discrete tax items.

Liquidity and Capital Resources

Our liquidity is dependent upon funds generated from operations and external sources of financing.

During the six months ended January 31, 2011, cash provided by operating activities was \$34.7 million compared to \$10.5 million for the six months ended January 31, 2010. The increase in cash provided by operating activities was primarily due to improved profitability. Cash used in investing activities was \$30.5 million during the six months ended January 31, 2011 compared to \$4.2 million for the six months ended January 31, 2010. This increase was mainly due to investments in production machinery at our Stockton and Fishers facilities, as well as restricted cash to be used for our Beloit plant expansion. Cash used in financing activities during the six months ended January 31, 2011 was \$7.7 million compared to \$19.1 million for the six months ended January 31, 2010. The decrease was primarily attributable to the proceeds from issuance of long-term debt.

In February 2010, we entered into an agreement to replace our existing credit facility with a new five-year \$600 million secured credit facility (the “Secured Credit Facility”) with a syndicate of lenders. We used the borrowings under the Secured Credit Facility to fund a portion of the Kettle Foods acquisition and to fund ongoing operations.

Our Secured Credit Facility consists of a \$200 million revolving credit facility, of which \$157.7 million was outstanding as of January 31, 2011, and a \$400 million term loan facility, of which \$370 million was outstanding as of January 31, 2011. Scheduled principal payments on the term loan are \$40 million for fiscal year 2011 and each of the succeeding three years (due quarterly), and \$10 million for each of the first two quarters in fiscal year 2015, with the remaining principal balance and any outstanding loans under the revolving credit facility to be repaid on the fifth anniversary of initial funding. Borrowings under the Secured Credit Facility will bear interest, at our option, at either the agent’s base rate or the LIBOR rate, plus a margin for LIBOR loans ranging from 2.25% to 3.50%, based on the consolidated leverage ratio which is defined as the ratio of total debt to EBITDA. Substantially all of our tangible and intangible assets are considered collateral security under the Secured Credit Facility.

The Secured Credit Facility also provides for customary affirmative and negative covenants, including a debt to EBITDA ratio and minimum fixed charge coverage ratio. As of January 31, 2011, we were in compliance with all applicable financial covenants under the Secured Credit Facility.

In March 2010, we issued 5,175,000 shares of common stock priced at \$37.00 per share. After deducting the underwriting discount and other related expenses, we received total net proceeds from the sale of our common stock of approximately \$179.7 million. The proceeds from the equity offering were used to fund a portion of the purchase price for the Kettle Foods acquisition.

On December 20, 2010, Kettle Foods obtained, and we guaranteed, a 10-year fixed rate loan (the “Guaranteed Loan”) in the principal amount of \$21.2 million. The principal and interest payments are due monthly throughout the term of the loan. The Guaranteed Loan will be used to purchase equipment for our Beloit, Wisconsin plant expansion. Borrowed funds have been placed in an interest-bearing escrow account and will be made available as expenditures are approved for reimbursement. As the cash will be used to purchase non-current assets, such restricted cash has been classified as non-current on the balance sheet. The Guaranteed Loan also provides for customary affirmative and negative covenants, which are similar to the covenants under the Secured Credit Facility. As of January 31, 2011, we were in compliance with all applicable financial covenants under the Guaranteed Loan.

Working capital and stockholders’ equity were \$88.6 million and \$428.7 million at January 31, 2011 compared to \$72.2 million and \$379.9 million at July 31, 2010 and \$61.0 million and \$197.2 million at January 31, 2010. The increase in working capital was due to increases in receivables and inventory related to the Kettle Foods acquisition and increases in raw material nut volume, offset by increases in current portion of long term debt, accounts payable and accrued liabilities.

We believe our cash and cash equivalents and cash expected to be provided from our operations, in addition to borrowings available under our Secured Credit Facility and restricted cash provided by the Guaranteed Loan, will be sufficient to fund our contractual commitments, repay obligations as required, and fund our operational requirements for at least the next twelve months.

Contractual Obligations and Commitments

Contractual obligations and commitments at January 31, 2011 were as follows (in millions):

	Payments Due by Period				
	Total	Less than 1 Year (e)	1-3 Years	3-5 Years	More than 5 Years
Revolving line of credit	\$ 157.7	\$ —	\$ —	\$ 157.7	\$ —
Long-term obligations	391.2	20.8	83.5	273.9	13.0
Interest on long-term obligations (a)	52.1	7.4	30.5	12.3	1.9
Operating leases	16.5	2.6	7.0	3.8	3.1
Purchase commitments (b)	70.7	47.1	23.6	—	—
Pension liability	24.0	0.3	4.3	1.4	18.0
Long-term deferred tax liabilities (c)	147.3	—	—	—	147.3
Other long-term liabilities (d)	3.3	0.1	1.4	0.3	1.5
Total	\$ 862.8	\$ 78.3	\$ 150.3	\$ 449.4	\$ 184.8

- (a) Amounts represent the expected cash interest payments on our long-term debt. Interest on our variable rate debt was forecasted using a LIBOR forward curve analysis as of January 31, 2011.
- (b) Commitments to purchase inventory and equipment. Excludes purchase commitments under Walnut Purchase Agreements due to uncertainty of pricing and quantity.
- (c) Primarily relates to intangible assets of Kettle Foods.
- (d) Excludes \$0.8 million in deferred rent liabilities. Additionally, the liability for uncertain tax positions (\$3.6 million at January 31, 2011, excluding associated interest and penalties) has been excluded from the contractual obligations table because a reasonably reliable estimate of the timing of future tax settlements cannot be determined.
- (e) Represents obligations and commitments for the remaining six months of fiscal year 2011.

Effects of Inflation

There has been no material change in our exposure to inflation from that discussed in our 2010 Annual Report on Form 10-K.

Critical Accounting Policies

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. Our critical accounting policies are set forth below.

Revenue Recognition. We recognize revenue when persuasive evidence of an arrangement exists, title and risk of loss has transferred to the buyer (based upon terms of shipment), price is fixed, delivery occurs and collection is reasonably assured. Revenues are recorded net of rebates, introductory or slotting payments, coupons, promotion and marketing allowances. The amount we accrue for promotion is based on an estimate of the level of performance of the trade promotion, which is dependent upon factors such as historical trends with similar promotions, expectations regarding customer and consumer participation, and sales and payment trends with similar previously offered programs. Customers have the right to return certain products. Product returns are estimated based upon historical results and are reflected as a reduction in sales.

Inventories. All inventories are accounted for on a lower of cost (first-in, first-out) or market basis.

We have entered into long-term Walnut Purchase Agreements with growers, under which they deliver their entire walnut crop to us during the Fall harvest season and we determine the purchase price for this inventory by March 31, or later, of the following year. This purchase price will be a price determined by us in good faith, taking into account market conditions, crop size, quality, and nut varieties, among other relevant factors. Since the ultimate price to be paid will be determined subsequent to receiving the walnut crop, we must make an estimate of price for interim financial statements. Those estimates may subsequently change and the effect of the change could be significant. In the three months ended January 31, 2011, we revised our estimate for expected walnut costs which resulted in a pre-tax increase in cost of sales of approximately \$1.2 million for walnut sales recognized in the first three months of fiscal year 2011. In the three months ended January 31, 2010, we revised our estimate for expected walnut costs which resulted in a pre-tax decrease in cost of sales of approximately \$2.6 million for walnut sales recognized in the first three months of fiscal year 2010.

Valuation of Long-lived and Intangible Assets and Goodwill. We periodically review long-lived assets and certain identifiable intangible assets for impairment in accordance with ASC 360, "Property, Plant, and Equipment." Goodwill and intangible assets not subject to amortization are reviewed annually for impairment in accordance with ASC 350, "Intangibles — Goodwill and Other," or more often if there are indications of possible impairment.

The analysis to determine whether or not an asset is impaired requires significant judgments that are dependent on internal forecasts, including estimated future cash flows, estimates of long-term growth rates for our business, the expected life over which cash flows will be realized, and assumed royalty and discount rates. Changes in these estimates and assumptions could materially affect the determination of fair value and any impairment charge. While the fair value of these assets exceeds their carrying value based on our current estimates and assumptions, materially different estimates and assumptions in the future in response to changing economic conditions, changes in our business or for other reasons could result in the recognition of impairment losses.

For assets to be held and used, including acquired intangible assets subject to amortization, we initiate our review whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows that the asset is expected to generate. Any impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Significant management judgment is required in this process.

For brand intangible assets not subject to amortization, we test for impairment annually, or whenever events or changes in circumstances indicate that their carrying value may not be recoverable. In testing brand intangibles for impairment, we compare the fair value with the carrying value. The determination of fair value is based on a discounted cash flow analysis, using inputs such as forecasted future revenues attributable to the brand, assumed royalty rates, and a risk-adjusted discount rate that approximates our estimated cost of capital. If the carrying value exceeds the estimated fair value, the brand intangible asset is considered impaired, and an impairment loss will be recognized in an amount equal to the excess of the carrying value over the fair value of the brand intangible asset.

We perform our annual goodwill impairment test required by ASC 350 as of June 30th of each year. In testing goodwill for impairment, we initially compare the fair value of the Company's single reporting unit with the net book value of the Company since it represents the carrying value of the reporting unit. We have one operating and reportable segment. If the fair value of the reporting unit is less than the carrying value of the reporting unit, we perform an additional step to determine the implied fair value of goodwill. The implied fair value of goodwill is determined by first allocating the fair value of the reporting unit to all assets and liabilities and then computing the excess of the reporting units' fair value over the amounts assigned to the assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill, the excess represents the amount of goodwill impairment. Accordingly, we would recognize an impairment loss in the amount of such excess. Our impairment assessment employs present value techniques and involves the use of significant estimates and assumptions, including a projection of future revenues, gross margins, operating costs and cash flows, as well as general economic and market conditions and the impact of planned business and operational strategies. We base our fair value estimates on assumptions we believe to be reasonable at the time, but such assumptions are subject to inherent uncertainty. Actual results may differ from these estimates. We also consider the estimated fair value of our reporting unit in relation to the Company's market capitalization.

We cannot guarantee that a material impairment charge will not be recorded in the future.

Employee Benefits. We incur various employment-related benefit costs with respect to qualified and nonqualified pension and deferred compensation plans. Assumptions are made related to discount rates used to value certain liabilities, assumed rates of return on assets in the plans, compensation increases, employee turnover and mortality rates. Different assumptions could result in the recognition of differing amounts of expense over different periods of time.

Income Taxes. We account for income taxes in accordance with ASC 740, "Income Taxes." This guidance requires that deferred tax assets and liabilities be recognized for the tax effect of temporary differences between the financial statement and tax basis of recorded assets and liabilities at current tax rates. This guidance also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. The recoverability of deferred tax assets is based on both our historical and anticipated earnings levels and is reviewed periodically to determine if any additional valuation allowance is necessary when it is more likely than not that amounts will not be recovered.

Accounting for Stock-Based Compensation. We account for stock-based compensation arrangements, including stock option grants and restricted stock awards, in accordance with the provisions of ASC 718, "Compensation — Stock Compensation." Under this guidance, compensation cost is recognized based on the fair value of equity awards on the date of grant. The compensation cost is then amortized on a straight-line basis over the vesting period. We use the Black-Scholes option pricing model to determine the fair value of stock options at the date of grant. This model requires us to make assumptions such as expected term, volatility, and forfeiture rates that determine the stock options' fair value. These key assumptions are based on historical information and judgment regarding market factors and trends. If actual results are not consistent with our assumptions and judgments used in estimating these factors, we may be required to increase or decrease compensation expense, which could be material to our results of operations.

Recent Accounting Pronouncements

See Note 2 of the condensed consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in our exposure to market risk from that discussed in our 2010 Annual Report on Form 10-K.

Item 4. Controls and Procedures

We have established and currently maintain disclosure controls and procedures designed to provide reasonable assurance that material information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission and that any material information relating to the Company is recorded, processed, summarized and reported to our principal officers to allow timely decisions regarding required disclosures.

In conjunction with the close of each fiscal quarter, we conduct a review and evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial and Administrative Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Our Chief Executive Officer and Chief Financial

and Administrative Officer, based upon their evaluation as of January 31, 2011, the end of the fiscal quarter covered in this report, concluded that our disclosure controls and procedures were effective.

As of January 31, 2011, there has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

We have various legal actions in the ordinary course of our business. All such matters are subject to many uncertainties that make their outcomes unpredictable. However, in our opinion, resolution of all legal matters is not expected to have a material adverse effect on our financial condition, operating results or cash flows.

Item 1A. Risk Factors

There were no material changes to the Risk Factors disclosed in the Company's Annual Report on Form 10-K for the year ended July 31, 2010.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following are details of repurchases of common stock during the three months ended January 31, 2011:

Period	Total number of shares repurchased (1)	Average price paid per share	Total number of shares repurchased as part of publicly announced plans	Approximate dollar value of shares that may yet be purchased under the plans
Repurchases from November 1 - November 30, 2010	—	\$ —	—	\$ —
Repurchases from December 1 - December 31, 2010	505	\$ 46.51	—	\$ —
Repurchases from January 1 - January 31, 2011	1,050	\$ 51.05	—	\$ —
Total	<u>1,555</u>	<u>\$ 49.57</u>	<u>—</u>	<u>\$ —</u>

- (1) All of the shares in the table above were originally granted to employees as restricted stock pursuant to our 2005 Equity Incentive Plan ("EIP"). Pursuant to the EIP, all of the shares reflected above were relinquished by employees in exchange for Diamond's agreement to pay federal and state withholding obligations resulting from the vesting of the restricted stock. The repurchases reflected above were not made pursuant to a publicly announced plan.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Removed and Reserved

Item 5. Other Information

After filing its annual report on Form 10-K for the fiscal year ended July 31, 2010, Company management determined that Note 5 of the Company's notes to consolidated financial statements, entitled "Acquisition of Kettle Foods", contained an error in the tabular presentation of 2009 pro forma financial information for the acquisition. This mathematical summation error resulted from the inadvertent omission of certain Kettle Foods sales and net income data from 2009 pro forma net sales and net income. The corrected pro forma financial information is set forth below (in thousands, except per share data):

	As previously reported	As corrected
2009 net sales	\$ 787,349	\$ 828,863
2009 net income	\$ 22,363	\$ 28,643
2009 diluted earnings per share	\$ 1.02	\$ 1.31

The correction does not impact the Company's consolidated balance sheets as of July 31, 2010 and 2009 or the related statements of operations and cash flows for the years ended July 31, 2010, 2009 and 2008. The Company does not believe the correction of this error is material to its consolidated financial statements.

Item 6. Exhibits

The following exhibits are filed as part of this report or are incorporated by reference to exhibits previously filed with the SEC.

Number	Exhibit Title	Filed with this		Incorporated by reference	
		10-Q	Form	File No.	Date Filed
3.01	Certificate of Incorporation, as amended		S1	333-123576	July 15, 2005
3.02	Restated Bylaws		S1	333-123576	March 25, 2005
4.01	Form of Certificate for common stock		S1	333-123576	July 18, 2005
31.01	Rule 13a-14(a) and 15d-14(a) Certification of Chief Executive Officer	X			
31.02	Rule 13a-14(a) and 15d-14(a) Certification of Chief Financial Officer	X			
32.01	Section 1350 Certifications	X			

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DIAMOND FOODS, INC.

Date: March 8, 2011

By: /s/ Steven M. Neil
Steven M. Neil
Chief Financial and Administrative Officer
and duly authorized officer

Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer

I, Michael J. Mendes, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended January 31, 2011 of Diamond Foods, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 8, 2011

By: /s/ Michael J. Mendes

Name: Michael J. Mendes

Title: Chairman of the Board, President and Chief
Executive Officer

Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer

I, Steven M. Neil, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended January 31, 2011 of Diamond Foods, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 8, 2011

By: /s/ Steven M. Neil

Name: Steven M. Neil

Title: Chief Financial and Administrative Officer

Section 1350 Certifications

Pursuant to 18 U. S. C. Section 1350, I, Steven M. Neil, hereby certify that, to the best of my knowledge, the Quarterly Report of Diamond Foods, Inc. on Form 10-Q for the quarter ended January 31, 2011 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, and that the information contained in that Report fairly presents, in all material respects, the financial condition and results of operations of Diamond Foods, Inc.

/s/ Steven M. Neil

Steven M. Neil
Chief Financial and Administrative Officer
Date: March 8, 2011

Pursuant to 18 U. S. C. Section 1350, I, Michael J. Mendes, hereby certify that, to the best of my knowledge, the Quarterly Report of Diamond Foods, Inc. on Form 10-Q for the quarter ended January 31, 2011 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, and that the information contained in that Report fairly presents, in all material respects, the financial condition and results of operations of Diamond Foods, Inc.

/s/ Michael J. Mendes

Michael J. Mendes
Chairman of the Board, President and Chief
Executive Officer
Date: March 8, 2011

These certifications accompany this Report on Form 10-Q shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the registrant specifically incorporates them by reference.