

GALAXY NUTRITIONAL FOODS, INC.

**Moderator: Chris New
June 28, 2004
9:00 a.m. CT**

Operator: Good day, everyone, and welcome to the Galaxy Nutritional Foods, Incorporated Fourth Quarter Fiscal 2004 Earnings Release conference call. Today's call is being recorded.

Presenting on the call today we have the Chief Executive Officer, Mr. Chris New and Chief Financial Officer, Mr. Salvatore Furnari. For opening remarks and introductions, I would like to turn the conference over to the Chief Executive Officer, Mr. Chris New. Please go ahead, sir.

Chris New: Thank you. Good morning. It's a pleasure to speak with our shareholders today in regards to our fiscal 2004 performance.

Throughout this year our management team continued to implement and refine our growth strategies, which resulted in improved operations, cash flow, gross margin percentage, net income, as adjusted, and EBITDA as adjusted as a percentage basis. The actions taken in fiscal '04 have further strengthened our business capabilities, and these are reflected in the positive results that we're reporting today.

Fiscal '04 marked a year of opportunity and challenge for many food companies, as several market factors impacted our business. On the positive side, Galaxy continues to create competitive insulation for our branded products by leveraging our premium product quality. By

delivering premium quality we provide our consumers with a superior experience and thus generate market share leadership. Having market share leadership and enhanced product quality leads to an ability to premium price versus competition and therefore generate premium margin. As margin improves management can reinvest those dollars in product quality initiatives, consumer demand building programs for our products, and business infrastructure and/or profit enhancement, et cetera.

We've gained a lot of consumer learning during fiscal '04. That's provided us with a basis for insight, which results in an ability to identify and communicate what brand benefits are most compelling, why, how and when consumers use our products. We believe that this learning can translate through refined strategies into continued positive market results.

For example, we conducted an in-market regional test, whereby the company dramatically shifted our marketing programs from trade driven, which are price reductions at the shelf, price feature ads and in-store merchandising, to consumer-driven efforts, like radio advertising, consumer coupons, in-store sampling so consumers can taste our product, on-pack coupons, co-op programs with key accounts, et cetera. And we found that we were able to significantly increase baseline volume on our branded products. This marketing effort was designed to take advantage of the key macro health trends amongst our consumer target, specifically addressing the issues of obesity, the bad fats, the need for better nutrition and increased taste satisfaction, to name a few.

Countering these types of marketing programs were market factors that we've talked about before. These have had a negative impact on our business. The first, consumer eating habits are changing with the publicly recognized trend towards low carbohydrate meal preparation during all meal occasions -- breakfast, lunch, snacks and dinner. This lead to decreased consumption of items such as bread and the company's primary products, which is our cheese slices.

Second, the numbers of consumers at retail grocery and natural food stores is down versus our prior year due to the further national emergence and presence of superstores, which include extensive grocery operations. In response to this change in consumer shopping, the company has redesigned our products in package formats to specifically target growing opportunities in superstore, warehouse club and other mass merchandiser markets.

Third, the veggie brand sales were down through the Southern California retail strike that occurred in fiscal '04. We're very happy that this labor issue has since been resolved.

Galaxy's go-to-market strategy has been refined during fiscal '04. We are significantly more consumer-focused. And in fiscal '05 our proven marketing programs will extend well beyond our regional test of '04. This strategy should certainly provide our company with every opportunity for continued business improvement as we move forward. We will continue to leverage our assets in operations and build additional brand value as we strategically accelerate our sales initiatives in fiscal '05. With our reduced debt service and more favorable debt structure, the company's in position to aggressively pursue our growth goals in fiscal '05.

At this point, I'd like to turn the conversation over to our Chief Financial Officer, Mr. Salvatore Furnari, for a review of our financial performance.

Salvatore Furnari: Thank you, Chris. Good morning, everyone. I'm sure most of you have seen the press release, which we issued this past Friday, which showed our financial results for the fiscal year ended March 31, 2004. Therefore, I'm only going to briefly highlight some of the more material line items in our financial statements.

First, on our statement of operations net sales decreased 9.5 percent from \$40 million in fiscal 2003 to \$36.2 million in fiscal 2004. This \$3.8 million decrease in net sales is primarily due to a

reduction in retail grocery sales of our sliced products. And Chris has already mentioned some of the primary market factors for this decline.

Gross margin percentage increased from 29.8 percent in fiscal 2003 to 31.3 percent in fiscal 2004, primarily due to increased production efficiencies achieved. Operating income, as adjusted, which excludes any non-cash compensation charges and employment contract expense, was \$890,000 in fiscal 2004 versus \$1,158,000 in fiscal 2003. This \$268,000 decrease in adjusted operating income is due to \$616,000 fewer margin dollars being offset by a \$348,000 decrease in operating expenses.

Next, interest expense decreased \$1.6 million or 53 percent from fiscal 2003 to fiscal 2004 due to the reduced debt outstanding and lower interest rates achieved through our refinancing that was completed in May of 2003. Excluding any non-cash compensation charges and employment contract expense, the company reported a net loss of \$481,000 for fiscal 2004 versus a net loss of \$1,873,000 for fiscal 2003. This \$1.4 million decrease in adjusted net loss was primarily due to the substantial reduction in interest expense, which I just mentioned.

And for the fourth quarter ended March 31, 2004, the company reported adjusted net income of \$86,000, excluding any non-cash compensation charges. This marks the second consecutive quarter of positive adjusted net income reported by the company.

Next, on our balance sheet the company's cash position improved by \$1.6 million when you compare the \$450,000 of cash reported at March 31, 2004 versus the \$1.2 million of book overdrafts reported at March 31, 2003. Trade receivables decreased by \$1 million from \$4.9 million at March 31, 2003 to \$3.9 million at March 31, 2004. This was primarily due to the lower sales volume in the fourth quarter of fiscal 2004 versus the same period in the prior year.

Accounts payable decreased substantially by \$1.4 million from \$2.6 million at March 31, 2003 versus \$1.2 million at March 31, 2004. And this decrease was primarily due to the payoff of a substantial amount of past due amounts after the company was refinanced last year.

Next on the statement of cash flows, the company increased its net cash from operating activities by \$1.1 million from \$1.18 million in fiscal 2003 to \$2.24 million in fiscal 2004. Finally, adjusted EBITDA, excluding any non-cash compensation charges and employment contract expense, was \$3.1 million or 8.5 percent of net sales for fiscal 2004 versus \$3.3 million or 8.3 percent of net sales for fiscal 2003.

And then finally I'd just like to briefly cover the loan amendments, which we had to take care of. We referred to this back on the prior conference call with the third quarter results. We did have to amend the Textron loan covenants due to the employment contract expense related to the Angelo Morini revised contract. And that was made effective December 31, 2003. And then as far as SouthTrust Bank, we did three separate things there. We needed to amend the loan covenants, again for the same item -- the employment contract expense. Again, those were effective 12-31-03 so we'd be in compliance. We did need to get a waiver for the fiscal 2004. There was a ratio -- maximum funded debt to EBITDA ratio, which is an annual ratio. And we needed to get a waiver for that. And then the third piece that was kind of bundled up altogether with SouthTrust was we achieved -- or negotiated a new pricing matrix with SouthTrust that by achieving future quarterly ratios that could result in a reduced interest rate on the term loan going forward.

That's basically all the points that I wanted to cover. And back to you, Chris.

Chris New: Thank you, Sal.

Looking forward, our growth plan and key initiatives for 2005 include creating competitive insulation through improved product development and quality, leveraging our strategic brand platforms through consumer marketing programming, new distribution, refined positioning of core brands, new products, introducing a new product position within the broader mass market appealing to a wider consumer target, and exploiting strategic sales opportunities to leverage unused manufacturing capacity and create margin for reinvestment into our core brands.

Given no significant change in the current business or economic environment, the company expects that annual net sales for 2005 will increase by 10 percent or more versus the prior fiscal year as key growth strategies are implemented in the marketplace and begin taking effect in first quarter of '05. We expect that we will report positive operating profits, excluding non-cash compensation charges, for fiscal '05 and that EBITDA, excluding non-cash compensation charges, should remain at positive levels throughout fiscal '05. And finally, we will report positive operating cash flow in fiscal '05.

I'd now like to open up the floor for questions and answers.

Operator: Thank you, gentlemen. The question-and-answer session will be conducted electronically. If you would like to ask a question, please do so by pressing the star key followed by the digit one on your touch-tone telephone. Also, if you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. And, once again, please press star one now on your touch-tone telephone to ask a question. And we'll pause for just a moment.

And we'll take our first question from Kyle Krueger of Apollo Capital.

Kyle Krueger: Morning, Chris. Morning, Sal.

Chris New: Good morning, Kyle.

Kyle Krueger: A question for you on redesigning the products and packaging for the superstores and warehouse club stores. Exactly what is the redesign?

Chris New: Well, you have to put the product into a format that meets that channel of distribution. So, it's typically a larger pack size, a higher dollar ring and a slightly different package design. For example, we'll create a two-pound bag of veggie shreds. And that's the item that we're currently going in to sell at Costco and we're having some success with. We'll also take that item into other form and/or that same form into other club stores and mass merchandisers.

Kyle Krueger: Got you. So, mainly larger pack size. It's not a significant revision in graphics and that sort of thing.

Chris New: No, we don't need to change the graphics for any specific channel of trade. We want to look at package formatting, from a one-pounder, two-pounder, different ounce sizes, shrink-wrapped packages together, those kinds of things. Packaging and graphics redesign will be incorporated into overall marketing planning in terms of generating higher purchase intent and consumer appeal across the entire marketplace.

Kyle Krueger: Yes, got you. And talk about where you're at with bringing some of these other customers on board, Chris. Are you close? Are you in test?

Chris New: I can't really speak too closely to that, as we're in process of selling that in. For example, Costco recently came on board and we continue to make progress with Wal-Mart relative to our existing and new SKUs. But I'd rather not discuss specifics relative to the plans of where we're going with the other folks, other than to say we're in the process of selling that in through quarter one and quarter two of this year and looking for beneficial impact in the second half.

Kyle Krueger: Yes. Yes. Got you. Any sign that the impact of low carb is starting to level off? Is it accelerating, decelerating? What's going on with the trend there?

Chris New: Yes. Everything that we read in the industry and we see in the marketplace regarding low carb is that it is seeking its own equilibrium right now. I believe there's about 12 percent of the U.S. population on a low carb diet right now. Twenty-two percent have tried low carb in the past year. So, you can kind of get a sense of the trial and repeat curve for the low carb craze. Twelve percent is a pretty high number relative to the size of the total U.S. population. What we're seeing is that our shred business and our chunk business is actually growing. That's very, very encouraging because that indicates, like I have talked in the previous conference call, that it's not an issue of consumers not liking our products. It's an issue of usage occasion. So, we're starting to see the form of shred and chunk begin to grow within our business. In regard to our slice business, which had been severely hit last year, we're seeing a little bit less pressure on this as we've been pointing out to consumers that our slices are low carb. However, I can't say it's exactly due to the low carb craze and/or some of our marketing programming, that's just my judgment. I don't really have a telescope (ie. Quantitative marketing research methods) into the market mix model that tells me exactly what low carb impact is on our business other than you can see the macro trend and its impact on complementary goods.

Kyle Krueger: Yes. Yes. Everybody, including you guys, clearly is experiencing cost pressures across the board. Can you comment on that and maybe when you would expect that to peak out? I mean, we've seen some of the grains come down materially, that kind of a thing. If you could comment on cost broadly.

Chris New: Yes. We have a cost containment and reduction program in place that Sal manages very, very aggressively. And at this point, what I can tell you, is that we're achieving all of our goals against that cost containment strategy.

In terms of key ingredient pricing, we certainly still are feeling the impact of and see that casein pricing is up and probably going up a little bit more in the future. We feel confident that our '05 budget is in pretty good shape and that we're managing aggressively to contain cost versus that budget. Casein is a fairly cyclical kind of ingredient, and we would expect by end of year that we will see pricing to start coming back down. We're also looking for alternative protein sources and mechanisms to offset the volatility of casein costs and thus hedge the impact. However, like I said, right now we feel pretty good that we've got this issue under control, that our costs are being managed appropriately.

Additionally, we initiated a price increase effective September 1st 2004. We sent out notification letters to our brokers and trade partners and expect to be recouping the impacts of inflationary costs of ingredients and packaging and reinvesting these dollars in strategic growth initiatives.

Kyle Krueger: You said that's as of September 1st?

Chris New: Effective September 1.

Kyle Krueger: Yes.

Chris New: Yes.

Kyle Krueger: OK. And we're two days before the end of the first quarter. What can you say about the first quarter in light of your fiscal '05 goals?

Chris New: We are in line with our fiscal '05 goal. We're having a very good first quarter. And I can state that our top line will be up 10 percent or more when we close in the next two days.

Kyle Krueger: Yes, great. Thanks.

Chris New: That looks good.

Operator: And, once again, it is star one if you do have a question or a comment. Moving on, we'll go to
PJ Solit with Potomac Capital.

PJ Solit: Hi. Good morning.

Chris New: Good morning.

PJ Solit: I actually came on just during that last question there, so maybe you already answered this. But
wanted to see if you talked at all about how Sysco is ramping up.

Chris New: We have not talked about Sysco yet. We continue to be in 10 to 15 of their warehouses with
the Sysco MoonRose program. We're now in the process of going out to the distributor and
operator level to begin the process of securing product for consumer sell-through. With that our
program is underway for '05. It is on track to achieving what we hope it will do in '05, but I can't
predict whether it will explode or whether it will just be a moderate level program at this point.

PJ Solit: OK. And what was the metrics on that again in terms of number of SKUs and things like that
that you've disclosed in the past?

Chris New: We have between five and seven SKUs authorized in the MoonRose program. They don't
specify or force your product into distribution, that's our responsibility.

PJ Solit: OK. Anything else in terms of talking about the business by product line in terms of kids or
salad dressing or desserts? Any of the other sort of non-historically core stuff?

Chris New: Yes. We have a new product development platform, which calls for late quarter four of '05 testing and implementation. We've gone through and ideated around consumer platforms, including everything that you just talked about, from kids driven products to desserts, to salad dressings, and more. We use a consumer-driven model, whereby we go to the consumer, assess their purchase intent, the concept/product fit, and then we determine how we should proceed to market. We're going to make sure that we prove it before we go into the marketplace and then go in and probably test market it before we launch on a regional or national basis.

PJ Solit: OK. And what about on the food service front -- I don't know if you've spoken about that yet -- in terms of restaurants?

Chris New: No, we have not spoken to that yet in this call. On the food service front, again, strategically we're going after the quick service restaurants, institutions, ingredient opportunities and also trying to find vehicles that allow us to get into the school system. Those are very slow burn kind of projects. Our existing food service business is up versus a year ago, so we're excited about that. We continue to have presence and test regionally in some of the larger quick service restaurant chains that we've talked in the past with the Subways and the Pizza Huts, but we don't have any kind of national agreement to move forward in a big way.

PJ Solit: OK. And what percentage of capacity would you say you're at right now in terms of manufacturing?

Chris New: Under 10 percent. So, we've got plenty of capacity from a production and shipping basis and now we're trying to generate the consumer demand around our branded products, layer in strategic sales opportunities that might be generic and/or private label in an effort to utilize operating assets and provide us leverage as we move forward.

PJ Solit: And the generic private level I think that's in the last quarter or two that you started to talk about doing that to fill up some capacity, if it makes sense, at the right price.

Chris New: Correct. And that's been an issue over the past two years, where we were specifically pushing that business away so we could solidify our core and restructure the balance sheet. That has been accomplished and we're running more efficiently and effectively, our growth strategies on a brand basis are taking hold -- gaining traction, and we can begin to layer that Private label and generic business back into our production mix, thus enable us to pump more volume through our facility.

PJ Solit: Have you taken some of that business yet, or that's not in anything we've seen yet?

Chris New: You'll see that in quarter one. This, in addition to branded volume has been an enabler to our top line growth in quarter one of '05.

PJ Solit: OK. All right. And then lastly just in your core markets what is the trend in SKUs there? Are you gaining or losing?

Chris New: Well, on a total SKU basis we've increased points of distribution. And now what we're doing going forward is we're leveraging our consumer marketing programs in more geography so that we can actually increase the velocity of sales on a broader basis. Again, we did a regional consumer marketing spending test this past year. We gained a lot of learning on the impact of that test. We grew our baseline volume, and clearly found that leveraging a combination of consumer programming with trade programming, we have a very effective way to grow our core brands. So, going forward in '05 we will expand that test to a much larger geography and take advantage of that program success as we go forward.

PJ Solit: OK. Thank you.

Chris New: You're welcome.

Operator: And there are no further questions in the queue at this time. As a final reminder, it is star one if you do have a question. And we'll pause for just a moment.

And we'll go to Chris Rimen-Schneider with Wachovia.

Chris Rimen-Schneider: Hi. I didn't see anywhere in the press release the fourth quarter sales. Can you -- if you -- I missed those on the beginning of the conference call. Can you go over those?

Salvatore Furnari: Right. The fourth quarter came in at \$8.5 million net sales, which was about a 12 percent decline or \$1 million from the third quarter. And about 85 percent of that was due to a decrease in sandwich slices ...

Chris Rimen-Schneider: OK.

Salvatore Furnari: ... non-branded.

Chris Rimen-Schneider: Thank you.

Salvatore Furnari: Sure.

Operator: And, Mr. New, it appears there are no further questions at this time. I'll turn the conference back over to you for any additional or closing remarks.

Chris New: In closing and looking forward, we're spending strategically against the consumer programs that we've developed and put in place for our branded platforms. Our intent here is to create

greater shareholder value and promote the growth of our business as we move the company from “defense to offense” in the marketplace. Now that we've got the working capital in place, the strategies refined and proven in the market, it's time to shift from “defense to offense”, to communicate with consumers, offering value at every opportunity and create a nice strong balance between our brand and our generic kind of business, increase the volume flow through our facility and take advantage of the assets that we have in place.

So I look forward to talking to you at the end of quarter one of '05 and reporting terrific results as a result. Thank you very much.

Operator: That concludes today's teleconference. We do thank you for your participation. You may disconnect.

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