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COMPANY SUMMARY

Tuesday, January 9, 2007

Speaker: Bob Cummins

Rating: Buy

Food Industry Comment:

ConAgra Foods (CAG-\$27.40)

	<u>F2006</u>	<u>F2007E</u>	<u>F2008E</u>	<u>Dividend/ Yield</u>	<u>Shares Out. (mil.)</u>	<u>12-Mo. Range</u>	<u>12-Mo. Target</u>
EPS (May)(a)	\$1.16	\$1.33	\$1.53	\$0.72	508.3	\$28-\$19	\$31-\$32
P/E	-	20.6x	17.9x	2.6%			

(a) Continuing operations. Excludes nonrecurring items.

We expected ConAgra Foods to report a healthy earnings gain for F2Q (November), since last year's results for the period were depressed. However, adjusted EPS of \$0.40 from continuing operations, up 38%, comfortably exceeded our estimate of \$0.35, up 21%. The better than expected results, released on December 21st, reflected a 400 basis point improvement in the operating margin of the Consumer Foods segment, to 18.0%, despite flat sales, and a healthy earnings increase in Trading and Merchandising, CAG's most volatile segment, following two quarters of sharp declines. A 24% drop in interest expense and a 2% reduction of shares outstanding, reflecting the use of cash from divestitures to reduce debt (by more than \$800 million) and repurchase shares, also helped the bottom line.

While the recent surge in trading profits may not be sustainable, it is clear that the efforts of CEO Gary Rodkin over the past 16 months to strengthen the performance of the consumer business and to divest less attractive operations are paying off. We are bullish on prospects for the February quarter, which showed mediocre results last year, and while management has raised its

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F2007 EPS guidance from \$1.17-\$1.22 (up 1%-5%) to \$1.28-\$1.33 (up 10%-15%), that could still prove conservative, in our opinion. On the other hand, the CAG shares, which have risen 45% from their March 2006 low, are not cheap, and could be vulnerable to profit-taking or unexpected disappointments, hence our rating of "2" (Buy) rather than "1" (Strong Buy). We have raised our 12-month target price from \$28-\$29 to \$31-\$32 to reflect CAG's better than expected results and higher valuations for the food stocks in general, but we would prefer to buy on weakness.

The **Consumer Foods** segment, accounting for 56% of sales and 60% of operating profit thus far in F2007, is one of the nation's leading marketers of branded food products, with annual sales of \$6.5 billion. It has a wide range of well-known brands including Healthy Choice, Orville Redenbacher's, Hunt's, Hebrew National, Pam, Egg Beaters, Chef Boyardee, Reddi-wip, Banquet, Blue Bonnet, Fleischmann's, La Choy, Marie Callender's, Parkay, Peter Pan, Slim Jim, Swiss Miss, Wesson and many others.

The strong gains in segment operating profits this year (24% in F1Q, 29% in F2Q) partly reflect weak results a year ago, but they also stem from a more favorable product mix, as the new management team has redirected marketing expenditures to emphasize the most promising brands. CAG's priority investment brands, which represent 75% of segment sales, on an overall basis achieved 2% sales growth in the latest quarter, while sales of other products declined 6%, including the impact of a divestiture and a phasing-out of some low-margin items. Segment profits have also benefited from increased efficiency, price increases, more moderate cost inflation, and better control of trade spending. Management expects a resumption of growth in segment sales in the second half, partly in response to increased marketing expenditures, and sees a further acceleration in F2008.

The company's second largest business segment, **Food and Ingredients**, has annual sales of \$3.3 billion, and accounted for 30% of sales and 29% of profits in the six months ended November. Its products are commercially branded foods and ingredients that are sold to foodservice, food manufacturing and industrial customers. Its best known subsidiary is Lamb Weston, the leading supplier of French fries and other potato products to restaurants around the world, including the major fast-food chains. It is also a leading flour miller, operating under the ConAgra Mills name. Other product lines include dehydrated vegetables, seasonings, blends and flavors for food manufacturers around the world. The division has been a consistent performer over recent years, although in F2Q, while sales increased 10%, profits were flat due to higher grain costs.

Trading and Merchandising, which accounted for 9% of revenues and 7% of profits in the first half, is strictly a commodities trader and merchandiser, specializing in agricultural commodities, fertilizer and energy worldwide, and thus is CAG's most volatile segment. After reporting year-to-year earnings declines of 25% in F4Q-06 and 71% in F1Q-07 (equal to estimated EPS

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reductions of \$0.03 and \$0.05, respectively), the segment showed an unexpected 19% (\$0.01) increase in the November period, reflecting strong energy trading profits. Segment earnings were strong in the February 2006 quarter, and management thus expects a resumption of year-to-year weakness.

Finally, **International Foods** are now reported as a separate segment for regulatory reasons, even though they represent a modest 5% of sales and 3% of profits, and are unlikely to become significantly larger in the near future. In the most recent quarter, sales declined 1% and operating profit 5%, as improved results in Canada and other markets were offset by lower earnings in Mexico and higher marketing expenditures.

For CAG as a whole, F2Q sales increased 3%, segment profits 20%, and operating profit after corporate expense 22%. Earnings also benefited from a 24% decline in interest expense, reflecting the use of divestiture proceeds to reduce net borrowings, which were \$2.8 billion at the end of the quarter, versus \$3.7 billion a year ago. Thus, net income from continuing operations increased 35%, and EPS from operations for the quarter (\$0.40 versus \$0.29) rose 38%, as shares outstanding declined 2%, reflecting the repurchase of 5.8 million shares for \$150 million, or an average of about \$25.86 per share.

Analyst's Certification

I Robert J. Cummins certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report. Other ConAgra Foods reports issued by me are: 3/4/05 (\$28) – Strong Buy – Target \$34-\$35; 5/20/05 (\$27) – Strong Buy – Target \$34-\$35; 7/8/05 (\$22.70) – Strong Buy – Target \$28-\$30; 9/14/05 (\$22.50) – Strong Buy – Target \$28-\$30; 9/29/05 (\$24.30) – Strong Buy – Target \$28-\$30; 12/13/05 (\$20) – Strong Buy – Target \$28-\$30; 1/12/06 (\$20.20) – Strong Buy – Target \$28-\$30; 1/23/06 (\$20.85) – Strong Buy – Target \$28-\$30; 3/21/06 (\$19.95) – Buy – Target \$22-\$23; 10/19/06 (\$25.70) – Buy – Target \$28-\$29.

Important Disclosures

Guide to Investment Ratings and Target Prices:

Strong Buy ("1"). The stock's total return is expected to exceed significantly the average total return of the analyst's industry coverage universe over the next 12 months.

Buy ("2"). The stock's total return is expected to exceed the average total return of the analyst's industry coverage universe over the next 12 months.

Hold (Neutral) ("3"). The stock's total return is expected to equal the average total return of the analyst's industry coverage universe over the next 12 months.

Sell ("4"). The stock's total return is expected to be below the average total return of the analyst's industry coverage universe over the next 12 months.

Analyst's Ratings Distribution

		% Investment Banking
Buy*	65%	0%
Hold	35%	0%
Sell	0%	0%

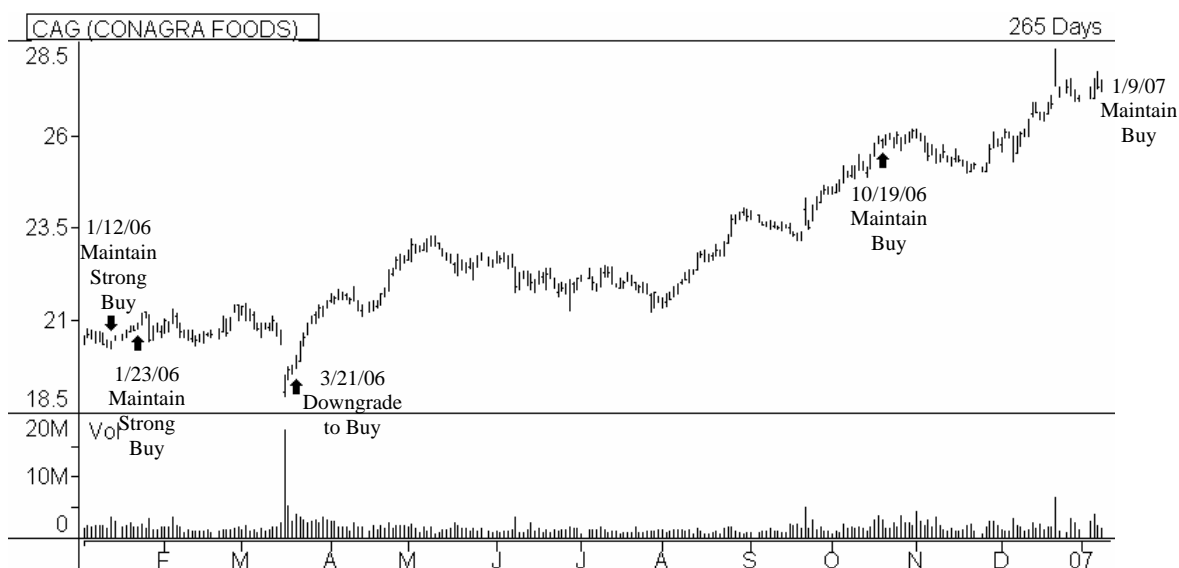
*Includes companies rated "Strong Buy" and "Buy."

Unless otherwise specified, the time frame for price targets included in this report is 12 months.

Our target prices are based on projected earnings for the following calendar year, and an assumed price/earnings ratio in line with the company's historical valuation or those of other companies with similar businesses and prospects.

The principal risks to the achievement of our price targets, in addition to general market trends, are disappointing earnings and a lower than expected price/earnings ratio.

Important Disclosures, continued



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