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COMPANY SUMMARY
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Speaker: Bob Cummins

Food Industry Comment:

ConAgra Foods (CAG- $26.70), having completed the divestiture of its volatile fresh beef, pork, chicken and agriproducts operations, which in F2002 accounted for 49% of sales but only 14% of profits, is now concentrating on building and strengthening its $12 billion a year brand-name packaged-foods business, which ranks as one of the largest in the industry. We were pleased with its results for F3Q (February), when sales and EPS, adjusted for the impact of divestitures and one-time items, increased 4% and 5%, respectively, despite the impact of higher input costs and other industry issues. We expect a stronger earnings increase in the May quarter, on a comparable basis, plus the added benefit of an extra week. The company remains on track in its broadly-based efforts to accelerate product innovation, to expand profit margins through product mix and increased efficiency, to enhance earnings growth, and thus to achieve recognition as one of the premier companies in the food industry. Despite a strong performance by the shares over the past six months, they remain reasonably priced at only 15 times our calendar 2004 estimate of $1.74, a 12% discount to the industry average, with an above-average 4% dividend yield. Rated "1" (Strong Buy), with a 12-month target price range of $32-$33, up from $31-$32 previously.

The Packaged Foods segment, which now accounts for some 80% of sales and 90% of profits, had a good third quarter, despite higher costs for energy and a wide range of agricultural commodities, notably meats, the principal ingredient in CAG's important packaged meat and turkey products. Excluding the seafood and cheese businesses divested in May, 2003, unit volume for the segment increased 2%, and dollar sales 4%. The company states that its top 30 consumer brands, which represent nearly two-thirds of the segment's sales, on a combined basis achieved a sales increase of more than 6%. Management cites the Armour, Banquet, Chef Boyardee, Cook's, Egg Beaters, Hebrew National, Hunt's, Marie Callendar's, PAM, Peter Pan, Reddi-wip, Rosarita, Slim Jim, Snack Pack, Swiss Miss, and Wesson brands as having performed particularly well, with several achieving double-digit sales increases. Sales to foodservice customers also showed growth.

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Operating profit for the segment increased 5%, slightly faster than sales, as higher profits for most product lines were partly offset by lower earnings from branded meats, reflecting not only higher costs but also competitive pressures. The operating margin of 14.2% was 40 basis points higher than a year ago on a reported basis, but after adjusting the prior-year figures for the divestiture of lower-margin operations, the improvement was only 10 bp. Management is not providing specific earnings guidance for F4Q (May), but the segment had disappointing results a year ago, and with the pressures in the meat area easing somewhat, we believe profits and margins should show a stronger year-to-year gain than in F3Q, even before allowing for the extra week, which will add nearly 8%.

The smaller Food Ingredients segment, which through August 2003 had suffered six straight quarters of severe earnings erosion, and then turned up in the November period, continued its strong rebound in F3Q, with earnings nearly twice those of a year ago. The turnaround reflects a slightly better business environment, increased operating efficiency, and the absence of prior-year inventory writedowns. The $25 million year-to-year increase in operating profit for this segment actually exceeded the $19 million rise in Packaged Foods, despite its much smaller size. The May quarter last year was also extremely depressed, and another strong comparison seems likely in F4Q-04.

Total profits for the two segments in the February quarter rose 10%, while lower corporate expenses led to a 14% operating profit rise for CAG as a whole. With the added benefit of lower interest expense, pretax income showed healthy 16% growth. The modest gain in EPS reflected two factors: (1) a 38.9% tax rate, versus 34.4% a year ago, as a result of a catchup adjustment; and (2) sharply lower equity income, evidently because of reduced profits at Swift, the joint venture which acquired CAG's fresh meat business 18 months ago, and in which it retains a minority interest. We calculate the combined impact at more than $0.04 per share, indicating that if the tax rate and equity income had been at prior-year levels, F3Q EPS from operations would have been $0.43, versus $0.37 a year ago, up 16%.

We estimate EPS for the May quarter, before an expected $0.04 restructuring charge, at $0.42 versus $0.31, including a $0.03 benefit from the extra week. That points to EPS from operations of $1.50 for the year. F2005 should get off to a strong start, in view of an easy comparison in the August quarter, when earnings a year ago were depressed. Our $1.80 estimate for the year assumes normal growth in F2Q and F3Q, followed by a modest gain in F4Q as the company reverts to the usual 13 weeks.

The company's financial condition and cash flow remain strong. At the end of February it had $534 million in cash, despite having spent $218 million in F3Q to repurchase 8.3 million shares, the first installment of a planned $1 billion buyback program. Net debt was $5.2 billion, $930 million lower than a year ago, compared with book equity of $4.9 billion, and an equity market value of $14 billion.

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. I have a long position in the shares of ConAgra Foods. Other reports issued by me are: ConAgra Foods ($26) 12/30/03-Strong Buy; General Mills ($46.50) 3/19/04-Strong Buy; Del Monte Foods ($11.10) 3/9/04-Strong Buy; PepsiCo ($48) 2/6/04-Strong Buy; SYSCO Corporation ($38) 1/27/04-Strong Buy; Sara Lee ($22) 2/27/04-Strong Buy; Sensient Technologies ($20) 3/5/04-Buy; Performance Food Group ($31.40) 3/9/04- Strong Buy; Dean Foods ($36) 2/27/04- Strong Buy; Heinz ($38) 3/5/04-Strong Buy.