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## COMPANY SUMMARY

Tuesday, July 17, 2007

Speaker: Bob Cummins

Rating: Strong Buy

Food Industry Comment:

### ConAgra Foods (CAG-\$27)

	<u>F2006</u>	<u>F2007</u>	<u>F2008E</u>	<u>Dividend/ Yield</u>	<u>Shares Out. (mil.)</u>	<u>12-Mo. Range</u>	<u>12-Mo. Target</u>
EPS (a)	\$1.16	\$1.51	\$1.52	\$0.72	490.0	\$28-\$21	\$31-\$32
P/E	-	-	17.8x	2.7%			

(a) May fiscal years. Excludes nonrecurring gains and charges.

ConAgra Foods achieved strong earnings growth in the May 2007 fiscal year, the first full year since Gary Rodkin took charge as CEO in October, 2005. EPS before one-time items were \$1.51, up 30%, and not far from the all-time high of \$1.60 in F2000, despite numerous divestitures in the interim. Consumer Foods, the largest division, reported 9% growth in operating income, on flat sales, as margins expanded significantly despite a substantial increase in marketing expenditures in F4Q. Trading and Merchandising had its best year in history, with profits rising 67%, including a remarkable five-fold increase in F4Q alone, as it took advantage of unusually volatile commodity markets. Management expects Consumer to achieve continued profit growth and a further widening of margins in F2008, but looks for profits in Trading to recede to more normal levels, resulting in relatively flat earnings for CAG overall. Our sense, however, is that that is more of a second half issue than an immediate concern, since trading profits were depressed in F1Q-07, and were within a normal range in F2Q. In any event, we are pleased by the ongoing strengthening of the Consumer segment, as well as favorable results in

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See page 9 for Analyst's Certification, pages 9-10 for Important Disclosures and pages 10-11 for Other Disclosures and Disclaimers

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the smaller Food and Ingredients business. These two divisions together account for some 80% of sales and segment profits. To the extent that Trading earnings may exceed investors' now-reduced expectations, that can only be a plus. Despite the rise in the stock price on the favorable earnings news, we maintain our "1" (Strong Buy) rating, as well as our 12-month target price of \$31-\$32.

ConAgra's **Consumer Foods** division in F2007 accounted for 54% of sales and 56% of operating income. It is one of the nation's largest marketers of brand-name food products, with annual sales of \$6.5 billion. Its brands are household names, as demonstrated by management's comment in the yearend earning release that major brands posting sales growth in F4Q included Blue Bonnet, Chef Boyardee, DAVID, Egg Beaters, Hebrew National, Kid Cuisine, Libby's, Marie Callender's, Manwich, Orville Redenbacher's, Reddi-wip, Rosarita, Slim Jim, Snack Pack and Wesson, while Act II, Knott's Berry Farm, La Choy, Parkay, Ro\*tel, Van Camp's and Wolf were down, and sales of Hunt's, PAM, Healthy Choice and Banquet were in line with F4Q-06. Other key brands not specifically mentioned include Swiss Miss, Brown 'N Serve, Crunch 'n Munch, Fleischmann's and Peter Pan.

Consumer sales were essentially flat for the year, which reflects a divestiture and the temporary withdrawal of Peter Pan peanut butter from distribution due to a product contamination issue. Management states that the company's priority brands – those on which marketing efforts are focused – showed a 4% sales gain. As mentioned, division operating profits showed healthy increases. At the end of nine months, they were up 21% over the prior year, and had it not been for a strategic decision to increase advertising and promotion investment in F4Q to take advantage of inflated profits in the commodity area, division profits would have been up at least 15% for the year. The operating margin for the year was 15.4% of sales (16.3% before the discretionary expenditures), versus 14.0% in F2006 and 14.6% in F2005.

Last year's strong profit gains in Consumer Foods were partly attributable to the fact that the benefits of cost reduction programs exceeded inflation in the cost of food ingredients and other inputs. In F2008, management expects the two to be about in balance, thus further profit growth will have to come from higher volume, price increases, product mix and other sources. The additional marketing expenses charged off in F4Q-07 should generate incremental business this year, while the absence of those charges will benefit segment profits in F4Q-08. All in all, management appears confident that F2008 will be another year of solid profit growth for the Consumer segment, even though progress in the first nine months will be slower than in F2007.

The **Trading and Merchandising** segment contributed 12% of sales and 32% of operating profit in F2007, up from 10% and 21% in F2006. Management considers a normal profit range for this

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business to be \$100-\$200 million per year. F2006 was near the high end of that range, at \$189 million. For the nine months ended February, 2007, earnings were \$117 million, down 20% from a year earlier due to a weak first quarter, and well within the normal range on an annualized basis. In the May quarter, profits soared to an unheard-of \$200 million (versus \$42 million a year ago), bringing the annual total to \$317 million, equal on an after-tax basis to about \$0.40 per share, compared with \$0.25 in F2006.

This division is comprised of three separate businesses, energy trading, fertilizer distribution, and the smallest unit, which trades a wide range of agricultural commodities. It has the third largest grain handling and storage system in the U.S., and is the leading global source of fertilizer components. It also has significant expertise in natural gas and crude oil. The company does not break out these activities, but commented in its quarterly reviews during F2007 that all three businesses were weak in F1Q (hence the sharp decline in segment profits); in F2Q, strong results in energy more than offset declines in the other two areas, leading to a healthy increase in overall profits; in F3Q, energy profits were down year-to-year, but improved fertilizer and agricultural profits barely offset the decline; and in F4Q, thanks to a favorable market environment, energy and fertilizer both surged to their highest profits for any quarter in history, and results in agricultural commodity trading also showed a year-to-year increase.

A few lessons can be learned from this scant information: (1) Commodity-related businesses are highly volatile, as illustrated by the fact that each of these units had two up quarters and two down quarters during F2007. (2) The company has a very easy comparison in F1Q, in view of last year's weakness. (3) Results in F2Q and F3Q were in a more normal range, although the sources of strength and weakness in each quarter were different. (4) F4Q was a blowout. (5) Our uneducated guess would be that some of the F4Q momentum will carry over into F2008, even though profits for the full year will almost certainly be down.

The **Food and Ingredients** segment, with F2007 sales of \$3.5 billion, is the company's second largest, accounting for 29% of sales and 23% of operating profit. Its principal business is Lamb Weston, the leading supplier of frozen French fries to restaurant chains around the world. Its other operations are ConAgra Mills, a leading U.S. flour miller; Gilroy Foods, which produces dehydrated garlic, onions and other ingredients for food manufacturers; and Spicetec, a leading source of seasonings and flavors. This segment has shown steady, relatively predictable growth, including increases of 9% in sales and 12% in operating profit in F2007.

The company's smallest segment is **International Foods**, which has annual sales of only \$600 million (5% of the total), and earned \$61 million (3%) in F2007, down from \$69 million (4%), and thus has little impact on overall results. International expansion does not seem to be a major priority for CAG's management at this time.

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On an overall basis, ConAgra reported sales growth of 5% for F2007, with Trading and Merchandising leading the way, up 23%. Total segment operating profits before one-time items increased 16%. Trading accounted for just over half of the dollar increase, although, as mentioned, Consumer Foods earnings were held down by discretionary expenditures in F4Q. General Corporate Expense, which tends to be fairly steady, also rose 16%, including a dramatic 45% increase in 4Q alone, as management took advantage of the abnormally large trading profits to accelerate some expenditures.

Net interest expense for the year was down 17%, as total borrowings at year-end, net of cash, declined from \$3.3 billion to \$2.7 billion. Thus, EBIT showed a 26% increase. A slightly higher tax rate (36.4%) was offset by increased equity income, thus net income from continuing operations, before one-time items, showed a similar 26% rise. The larger 30% increase in EPS reflects a 2.5% decline in average shares outstanding, as a result of \$600 million of share repurchases during the year. ConAgra generates a considerable amount of excess cash, after allowing for capital expenditures and dividends, and we expect that share repurchases will continue at a high rate in F2008.

**Table 1: ConAgra Foods, Inc. - Quarterly Summary (millions except EPS) (a)**

	Continuing Operations							
	F2007		F2006		F2005	F2006		F2005
<b>August</b>								
Net Sales	\$2,688.6	+1%	\$2,673.8	+2%	\$2,630.6	\$3,362.9	(1)%	\$3,383.2
Cost of Goods Sold	2,025.6		2,003.1		1,995.1	2,635.4		2,700.4
Gross Profit	663.0	(1)	670.7	+6	635.5	727.5	+7	682.8
SG&A Expenses	398.2		391.0		376.5	427.0		386.1
Operating Profit	264.8	(5)	279.7	+8	259.0	300.5	+1	296.7
Interest Expense, Net	58.0		72.4		73.4	68.1		73.4
Income Before Taxes	206.8	-	207.3	+12	185.6	232.4	+4	223.3
Income Taxes	75.8		82.3		74.6	74.6		91.4
Income After Taxes	131.0	+5	125.0	+13	111.0	157.8	+20	131.9
Equity Earnings	2.2		5.1		14.1	7.9		14.1
Net Income	\$133.2	+2%	\$130.1	+4%	\$125.1	\$165.7	+13%	\$146.0
Diluted Shares	512.4	(2)%	520.5	-	521.4	520.5	-	521.4
EPS	\$0.26	+4	\$0.25	+4%	\$0.24	\$0.32	+14%	\$0.28
% of Sales								
Gross Profit	24.7%		25.1%		24.2%	21.6%		20.2%
SG&A Expenses	14.9		14.6		14.4	12.7		11.4
Oper. Profit	9.8		10.5		9.8	8.9		8.8
Effective Tax Rate	36.7%		39.7%		40.2%	32.1%		40.9%
<b>November</b>								
Net Sales	\$3,088.7	+3%	\$3,002.0	(4)%	\$3,118.2	\$3,810.2	(5)%	\$4,009.1
Cost of Goods Sold	2,278.4		2,270.6		2,311.3	3,003.0		3,108.1
Gross Profit	810.3	+11	731.4	(9)	806.9	807.2	(10)	901.0
SG&A Expenses	445.1		431.4		406.8	440.2		433.4
Operating Profit	365.2	+22	300.0	(25)	400.1	367.0	(22)	467.6
Interest Expense, Net	52.1		68.6		85.8	62.2		85.8
Income Before Taxes	313.1	+35	231.4	(26)	314.3	304.8	(20)	381.8
Income Taxes	117.2		87.6		126.1	114.1		151.3
Income After Taxes	195.9	+36	143.8	(24)	188.2	190.7	(17)	230.5
Equity Earnings	8.6		7.3		15.1	7.3		15.1
Net Income	\$204.5	+35%	\$151.1	(26)%	\$203.3	\$198.0	(19)%	\$245.6
Diluted Shares	511.3	(2)%	521.0	+1%	517.5	521.0	+1%	517.5
EPS	\$0.40	+38	\$0.29	(26)	\$0.39	\$0.38	(19)%	\$0.47
% of Sales								
Gross Profit	26.2%		24.4%		25.9%	21.2%		22.5%
SG&A Expenses	14.4		14.4		13.0	11.6		10.8
Oper. Profit	11.8		10.0		12.8	9.6		11.7
Effective Tax Rate	37.4%		37.9%		40.1%	37.4%		39.6%

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**Table 1: (Continued)**

	Continuing Operations					
	F2007		F2006		F2005	
<b>February</b>	(b)					
Net Sales	\$2,918.4	+2%	\$2,861.8	+4%	\$2,756.3	\$3,569.9
Cost of Goods Sold	2,076.7		2,137.4		2,046.1	2,803.5
Gross Profit	841.7	+16	724.4	+2	710.2	766.4
SG&A Expenses	453.2		405.7		397.6	420.9
Operating Profit	388.5	+22	318.7	+2	312.6	345.5
Interest Expense, Net	56.1		68.8		68.1	68.1
Income Before Taxes	332.4	+33	249.9	+2	244.5	277.4
Income Taxes	109.7		86.4		92.1	101.0
Income After Taxes	222.7	+36	163.5	+7	152.4	176.4
Equity Earnings	9.6		8.4		7.0	3.6
Net Income	\$232.4	+35%	\$171.9	+8%	\$159.4	\$180.0
Diluted Shares	506.7	(3)%	520.9	-	520.3	517.5
EPS	\$0.45	+36	\$0.33	+6%	\$0.31	\$0.34
						\$0.37 +9%
% of Sales						
Gross Profit	28.8%		25.3%		25.8%	21.5%
SG&A Expenses	15.5		14.2		14.5	11.8
Oper. Profit	13.3		11.1		11.3	9.7
Effective Tax Rate	33.0%		34.6%		37.7%	36.4%
<b>May</b>	(b)					
Net Sales	\$3,332.5	+13%	\$2,944.4	(2)%	\$2,998.6	\$3,706.4
Cost of Goods Sold	2,437.3		2,227.5		2,313.8	2,960.5
Gross Profit	895.2	+25	716.9	+5	684.8	745.9
SG&A Expenses	557.0		427.8		430.9	470.8
Operating Profit	338.2	+17	289.1	+14	253.9	275.1
Interest Expense, Net	59.4		62.2		67.7	67.7
Income Before Taxes	278.8	+23	226.9	+22	186.2	207.4
Income Taxes	99.7		85.1		76.4	81.8
Income After Taxes	179.1	+26	141.8	+29	109.8	125.6
Equity Earnings	20.0		5.6		10.0	9.9
Net Income	\$199.1	+35%	\$147.4	+23%	\$119.8	\$135.5
Diluted Shares	498.2	(4)%	519.1	-	521.0	521.0
EPS	\$0.40	+43	\$0.28	+22%	\$0.23	\$0.26
						\$0.32 +23%
% of Sales						
Gross Profit	26.8%		24.3%		22.8%	20.1%
SG&A Expenses	16.7		14.5		14.3	12.7
Oper. Profit	10.1		9.8		8.5	7.4
Effective Tax Rate	35.8%		37.5%		41.0%	39.4%

(a) Excludes nonrecurring gains and charges.

(b) Excludes charge for product recall.

**Table 2: ConAgra Foods, Inc. - Quarterly Segment Results (millions) (a)**

	F2007		F2006		F2005
<b>Aug. - Net Sales:</b>					
Consumer Foods	\$1,509.6	+1%	\$1,499.5	(3)%	\$1,549.3
Food & Ingredients	831.5	+8	770.5	+6	728.1
Trading & Merchandising	205.4	(21)	260.0	+17	222.9
International Foods	142.1	(1)	143.8	+10	130.3
Total	<u>\$2,688.6</u>	+1%	<u>\$2,673.8</u>	+2%	<u>\$2,630.6</u>
<b>Operating Profit:</b>					
Consumer Foods	\$206.6	+24%	\$166.4	(11)%	\$187.0
Food & Ingredients	106.3	+10	96.4	+9	88.8
Trading & Merchandising	15.6	(71)	53.5	+55	34.6
International Foods	13.1	(24)	17.3	+42	12.2
Segment Total	<u>\$341.6</u>	+3	<u>\$333.6</u>	+3	<u>\$322.6</u>
General Corp. Expense	76.8	+5	72.9	+15	63.6
Company Total	<u>\$264.8</u>	+2%	<u>\$260.7</u>	+1%	<u>\$259.0</u>
<b>Operating Margin:</b>					
Consumer Foods	13.7%		11.1%		12.1%
Food & Ingredients	12.8		12.5		12.2
Trading & Merchandising	7.6		20.6		15.5
International Foods	9.2		12.0		9.4
Segment Total	<u>12.7</u>		<u>12.5</u>		<u>12.3</u>
General Corp. Expense	(2.9)		(2.7)		(2.5)
Company Total	<u>9.8%</u>		<u>9.8%</u>		<u>9.8%</u>
<b>Nov. - Net Sales:</b>					
Consumer Foods	\$1,752.2	-	\$1,753.2	(8)%	\$1,898.0
Food & Ingredients	885.7	+10%	805.3	+7	750.3
Trading & Merchandising	297.3	+3	288.6	(8)	315.0
International Foods	153.5	(1)	154.9	-	154.9
Total	<u>\$3,088.7</u>	+3%	<u>\$3,002.0</u>	(4)%	<u>\$3,118.2</u>
<b>Operating Profit:</b>					
Consumer Foods	\$314.7	+29%	\$244.6	(24)%	\$321.7
Food & Ingredients	92.0	-	91.9	+4	88.6
Trading & Merchandising	38.9	+19	32.7	(34)	49.6
International Foods	14.2	(5)	14.9	(13)	17.2
Segment Total	<u>\$459.8</u>	+20	<u>\$384.1</u>	(19)	<u>\$477.1</u>
General Corp. Expense	94.6	+12	84.1	+9	77.0
Company Total	<u>\$365.2</u>	+22%	<u>\$300.0</u>	(25)%	<u>\$400.1</u>
<b>Operating Margin:</b>					
Consumer Foods	18.0%		14.0%		16.9%
Food & Ingredients	10.4		11.4		11.8
Trading & Merchandising	13.1		11.3		15.7
International Foods	9.3		9.6		11.1
Segment Total	<u>14.9</u>		<u>12.8</u>		<u>15.3</u>
General Corp. Expense	(3.1)		(2.8)		(2.5)
Company Total	<u>11.8%</u>		<u>10.0%</u>		<u>12.8%</u>

(Continued)

**Table 2: (Continued)**

	<u>F2007</u>		<u>F2006</u>		<u>F2005</u>
<b>Feb. - Net Sales:</b>					
Consumer Foods	\$1,619.0	(2)%	\$1,644.4	+1%	\$1,625.7
Food & Ingredients	851.9	+8	789.8	+8	733.4
Trading & Merchandising	293.3	+5	278.3	+7	259.3
International Foods	154.2	+3	149.3	+8	137.9
Total	<u>\$2,918.4</u>	+2%	<u>\$2,861.8</u>	+4%	<u>\$2,756.3</u>
<b>Operating Profit:</b>					
Consumer Foods	\$291.2b	+11%	\$261.2	+1%	\$258.3
Food & Ingredients	109.3	+36	80.2	+4	76.9
Trading & Merchandising	62.3	+3	60.6	+5	57.6
International Foods	16.9b	+18	14.3	+5	13.6
Segment Total	<u>\$479.7</u>	+15	<u>\$416.3</u>	+2	<u>\$406.4</u>
General Corp. Expense	90.9	(7)	97.6	+4	93.8
Company Total	<u>\$388.8</u>	+22%	<u>\$318.7</u>	+2%	<u>\$312.6</u>
<b>Operating Margin:</b>					
Consumer Foods	18.0%		15.9%		15.9%
Food & Ingredients	12.8		10.2		10.5
Trading & Merchandising	21.2		21.8		22.2
International Foods	11.0		9.6		9.9
Segment Total	<u>16.4</u>		<u>14.5</u>		<u>14.7</u>
General Corp. Expense	(3.1)		(3.4)		(3.4)
Company Total	<u>13.3%</u>		<u>11.1%</u>		<u>11.3%</u>
<b>May - Net Sales:</b>					
Consumer Foods	\$1,604.5	-	\$1,607.3	(1)%	\$1,642.4
Food & Ingredients	912.6	+11%	823.0	+6	774.0
Trading & Merchandising	659.2	+84	358.9	(16)	427.1
International Foods	156.2	+1	155.2	-	155.1
Total	<u>\$3,332.5</u>	+13%	<u>\$2,944.4</u>	(1)%	<u>\$2,998.6</u>
<b>Operating Profit:</b>					
Consumer Foods	\$184.7b	(23)%	\$241.1	+14%	\$211.4
Food & Ingredients	105.0	+5	100.1	+26	79.6
Trading & Merchandising	200.3	(c)	42.0	(25)	56.0
International Foods	17.2	(24)	22.6	+15	19.7
Segment Total	<u>\$507.2</u>	+25	<u>\$405.8</u>	+11	<u>\$366.7</u>
General Corp. Expense	169.0	+45	116.7	+3	112.8
Company Total	<u>\$338.2</u>	+17%	<u>\$289.1</u>	+14%	<u>\$253.9</u>
<b>Operating Margin:</b>					
Consumer Foods	11.5%		15.0%		12.9%
Food & Ingredients	11.5		12.2		10.3
Trading & Merchandising	30.4		11.7		13.1
International Foods	11.0		14.6		12.7
Segment Total	<u>15.2</u>		<u>13.8</u>		<u>12.2</u>
General Corp. Expense	(5.1)		(4.0)		(3.7)
Company Total	<u>10.1%</u>		<u>9.8%</u>		<u>8.5%</u>

(a) Continuing operations. Excludes nonrecurring gains and charges.

(b) Excludes charge for product recall. (c) Not meaningful.

## 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; 1/9/07 (\$27.40) – Buy – Target \$31-\$32; 3/28/07 (\$24.60) – Strong Buy – Target \$31-\$32.

## 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*	71%	0%
Hold	29%	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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