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COMPANY SUMMARY

Wednesday, September 14, 2005

Speaker: Bob Cummins

Food Industry Comment:

ConAgra Foods (CAG-\$22.50) passed an important milestone on August 31st with the announcement of its new president and CEO, Gary Rodkin, a high-profile executive with 25 years' experience at several leading food and beverage companies, most recently PepsiCo. We consider Mr. Rodkin's decision to join CAG a significant plus, based both on his ability to continue the upgrading of the company that began in 1997 under Bruce Rohde, and on his prominence in the consumer goods industry, which should strengthen the confidence of the company's retail customers as well as its investors.

Despite a favorable initial reaction to Mr. Rodkin's appointment, the shares remain depressed, trading barely above the two-year low reached last month, and at only 15 times estimated recovery earnings of \$1.50 per share. The \$1.09 dividend, which we expect will be maintained, provides a 4.8% yield, the highest in the food industry. Investors' caution reflects the likelihood of at least one more disappointing quarter (to be reported on September 21st) before earnings start to rebound. Based on our confidence in Gary Rodkin, and in the potential for CAG's businesses, we are reemphasizing our Strong Buy ("1") rating, and our 12-month target price of \$28-\$30.

Bruce Rohde, age 56 and a lawyer by profession, was CAG's long-time outside counsel and a member of its board of directors when he was designated CEO in 1997. He subsequently embarked on a program that transformed the company from a food industry conglomerate engaged in operating feedlots, slaughtering livestock, producing chickens and distributing agricultural chemicals, to a highly focused packaged-foods manufacturer, deriving over 80% of sales from value-added, brand-name products. Its annual sales of \$15 billion make it one of the largest food companies in the U.S., and it has a wide array of brands with strong consumer recognition. We believe Mr. Rohde's decision in May to begin a search for a successor reflected his judgment that after the numerous divestitures of commodity-type businesses over the past several years, it was time to turn the reins over to an operations-oriented executive with marketing expertise, to take full advantage of CAG's opportunities for both top-line growth and enhanced profitability. Earnings pressures in the company's important packaged meats business over the past several quarters may have hastened his decision.

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See pages 4 to 6 of report for important disclosures and Analyst's Certification.

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Gary Rodkin, age 53, began his food industry career at General Mills in 1979, remaining there for 16 years, and serving as president of the rapidly-growing yogurt division for the final three years. In 1995, he left GIS to become president of North American operations for Tropicana, and became part of the PepsiCo organization when it acquired that company in 1998. By 2000, he was president and CEO of Pepsi-Cola North America, with annual sales exceeding \$3 billion. At the time of his resignation to take the CAG position, he was chairman and CEO of PepsiCo Beverages & Foods North America, one of PEP's three broad business units, which encompasses not only soft drinks but also Tropicana and Gatorade beverages, as well as Quaker food products, with total sales of \$10 billion. His decision to leave was motivated by a desire to be CEO of a public company, and by the fact that Steve Reinemund, chairman and CEO of PepsiCo, is only 56, and clearly intends to remain in that position for some time to come.

In conjunction with the Rodkin announcement, CAG also announced the election of Steve Goldstone, a member of the board, as its new non-executive chairman beginning October 1. Mr. Goldstone, who led the search committee for a new CEO, is the former chairman and CEO of RJR Nabisco, and the former chairman of Nabisco, Inc., Nabisco Holdings, and Nabisco Group Holdings. He was the architect of the plan to spin off the RJR tobacco business in 1999, and subsequently to sell the Nabisco companies to Kraft in 2000, resulting in significant benefits to his shareholders. We have great respect for Mr. Goldstone's business acumen, and expect that he and Mr. Rodkin will be a powerful team.

Separately, on August 30th, the company announced another management addition, Lou Nieto, age 50, who will assume the position of President, Packaged Meats and Deli. As mentioned, that area has been a principal source of CAG's recent earnings problems, and while internal changes in management and strategies were already being implemented, we view the addition of a seasoned food industry executive to oversee those changes as constructive. Most recently, Mr. Nieto was president and CEO of Federated Group, Inc., a privately held provider of products and services to grocery retailers. Previously, he held senior positions at Dean Foods and Mission Foods.

Some analysts are predicting that after CEO Rodkin joins the company, he will recommend that the board reduce ConAgra's dividend, which represents a relatively high 81% of trailing 12-month EPS from operations. They may be recalling the situation at Campbell Soup in July, 2001, when newly-hired CEO Doug Conant announced an ambitious transformation program to accelerate the company's growth, which included increased capital expenditures, a larger marketing budget, a 20% reduction of near-term earnings expectations, and a 30% cut in the dividend. However, the two situations differ in several respects, one of which is share ownership. Campbell is a closely held company in which members of the wealthy Dorrance family, descendants of the founder, own 48% of the stock, and hold 5 of the 16 seats on the board of directors. Clearly Mr. Conant was able to persuade them that his plan was in their long-

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term interest, particularly since they would still be receiving total dividends of \$123 million per year. In contrast, ConAgra's insider ownership is only 3%, with most of the shares held, either directly or through mutual funds, by individual investors for whom the above-average dividend is important.

A number of other considerations also argue in favor of the present dividend being maintained:

- Earnings currently are temporarily depressed, particularly in the meat business, and the payout ratio will decline as they recover to more normal levels, and eventually, we believe, to new highs.
- Even at the present earnings level, CAG generates excess cash. In F2005, excluding nonrecurring gains and charges, net income, depreciation and other noncash items totalled \$1.1 billion, while capital expenditures and dividends amounted to \$1.0 billion. Free cash flow should increase in F2006, as net income is expected to rise, while capital spending will be at least \$50 million less than the past year's record high.
- The changes in the tax laws in 2003 made dividend income much more attractive to investors, and as a result most food companies, as well as those in other industries, have been placing an increased emphasis on dividend payments, raising their payout ratios rather than reducing them.
- The company's latest annual report states that "Dividends represent an important component of shareholder returns....ConAgra Foods has long had a goal of paying out a significant portion of the cash it generates and has continuously delivered upon this goal." Over the past five years, CAG's annual dividends per share have compounded at 6.5% a year, despite the divestiture of non-core businesses that had accounted for 53% of sales and made an important contribution to earnings.
- Mr. Rodkin's previous employer, PepsiCo, also has long had a dividend-friendly policy, with steady increases over the years. It was one of the first companies to respond directly to the new tax treatment of dividends, when it announced a dramatic 44% increase in its annual rate in March, 2004, driving the stock to a new all-time high.
- While ConAgra's stock is trading 25% below its 12-month high, it seems clear that the dividend is helping to support it here, in view of a still uncertain earnings outlook, and a trailing P/E multiple of nearly 17 times. In our opinion, a dividend cut would cause the shares to fall to a new low. One of the major losers would be Gary Rodkin himself, inasmuch as on August 31st he received a one-time grant of 1,000,000 stock options with an exercise price of \$22.83, the closing price that day.

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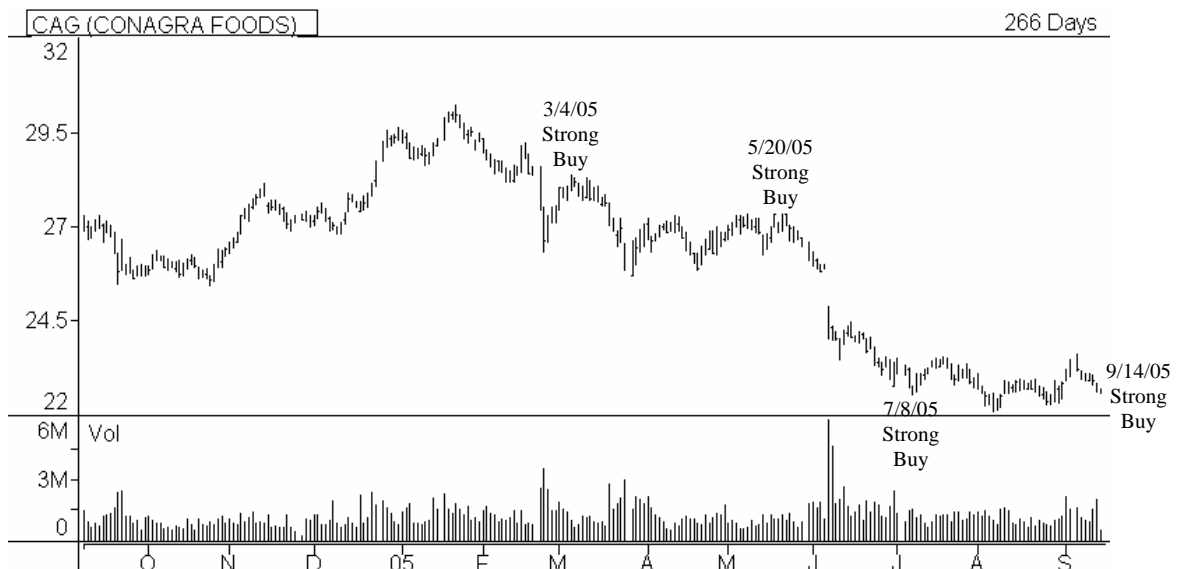
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