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COMPANY SUMMARY

Thursday, October 2, 2008

Speaker: Bob Cummins

Rating: Strong Buy

Food Industry Comment:

ConAgra Foods (CAG-\$20)

	<u>F2007</u>	<u>F2008</u>	<u>F2009E</u>	<u>F2010E</u>	<u>Dividend/ Yield</u>	<u>Shares Out. (mil.)</u>	<u>12-Mo. Range</u>	<u>12-Mo. Target</u>
EPS (a)	\$1.06	\$1.11	\$1.52	\$1.75	\$0.76	489.2	\$26-\$19	\$27-\$28
P/E	-	-	13.2x	11.4x	3.8%			

(a) May fiscal years. Excludes nonrecurring gains and charges. Earnings based on continuing operations, Excluding divested Trading & Merchandising division.

ConAgra Foods' shares have performed poorly during calendar year 2008, declining 27% from a December 2007 high of \$26.22 to a September 2008 low of \$19.05, one of the weakest showings in the food industry. The price erosion reflects two principal influences: (1) six consecutive quarters of year-to-year earnings declines in the Consumer Foods segment, as a result of inflationary cost pressures; and (2) the June divestiture of CAG's Trading & Merchandising operations, which were highly volatile and very likely near a cyclical peak, but did contribute a substantial 44% of after-tax net income (\$0.84 per share) in the May 2008 fiscal year.

That said, we believe it is time to take a fresh look at ConAgra. The company took aggressive pricing action in late March and again in August to offset higher costs, while in the meantime prices for key agricultural commodities have been declining over the past several months, as has the price of oil. In addition, the \$2.8 billion proceeds from the sale of the Trading business are being applied to debt reduction and aggressive share repurchases, which will help to offset the lost income. Management appears confident that after a slow start in F1Q, EPS for F2009 will exceed \$1.50, representing a nearly 40% increase over last year's \$1.11. We are reemphasizing our "1" (Strong Buy) rating, while shading our target price from \$29-\$30 to \$27-\$28 to reflect

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reduced earnings estimates. Combined with the attractive \$0.76 (3.8%) dividend, that represents a total return of 39%-44%.

Since CEO Gary Rodkin joined CAG from PepsiCo in October, 2005, he has taken many constructive steps to strengthen the company, including both divestitures and acquisitions in the consumer area, restructuring steps in the ongoing operations, and changes in management. His most dramatic action was the sale of the Trading & Merchandising business, which as recently as two years ago was a relatively minor part of the company's operations, but which had become a disproportionate contributor to profits thanks to rising prices and increased volatility in the commodity markets.

In the meantime, those same inflationary trends for food ingredients, packaging materials, energy and other inputs were putting increasing pressure on profit margins in the **Consumer Foods** segment. CAG was more cautious in passing on the higher costs than many of its competitors, in part because of concerns about relations with its retail customers in the wake of two major product recalls, involving Peter Pan peanut butter in F2007, and Banquet and private label pot pies in F2008. For the 12 months ended in February, 2007, before margin erosion set in, the Consumer Foods operating margin was a healthy 15.8% of sales. By contrast, for the latest 12 months through August, 2008, the segment earned only 11.5%, down 430 basis points. Operating income in dollars was 22% below that of the earlier period, despite 7% higher sales.

More recently, the outlook has improved. The company raised prices on 95% of its consumer lines in late March, and for the May quarter, Consumer Foods profits were just 4% below a year earlier (on 7% higher sales), after four consecutive quarters of double-digit declines. Management had expected a further improvement in the August quarter, but instead further increases in costs led to a 6% decline in operating profits for the segment, despite a 9% increase in sales. That led to a further round of price increases in late August. Pre-buying by some customers will delay the impact, but management clearly believes that better times lie ahead.

Besides price increases, another reason for optimism about Consumer Foods profits going forward is that prices for agricultural commodities may be entering a declining phase, especially if economic trends in the U.S. and worldwide weaken. Table 4 summarizes price trends for four key food commodities, corn, soybeans, wheat and milk, over the past three years. The rising trends for all four can be clearly seen. In the case of corn, for example, the average price per bushel in January, 2008, was 131% higher than in the same month two years earlier. The corresponding increases for soybeans, wheat and milk were 115%, 114% and 42%, respectively.

More recently, however, those trends have reversed, an encouraging development if it continues. In 2006 and 2007, prices for corn, soybeans and wheat all sold at their annual highs in either

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November or December, which portended further inflation in the year ahead. This year, however, the price of corn appears to have peaked in June, and by September it was down 26% from that level. Soybeans reached their annual high to date in July, and are down 24% from that price, while wheat reached its high earlier, in March, and has declined 37%. Milk is a separate case, but there also, the current price is 20% below that in June. Prices for all four commodities are still well above those of two years ago, with plenty of room on the downside if recent trends continue.

ConAgra's other business segment is **Commercial Foods**, with annual sales of \$4.4 billion, which is now combined for reporting purposes with the company's relatively small International business, and in the past 12 months accounted for 37% of sales and operating profits. As stated in Form 10-K, this segment includes "commercially branded foods and ingredients, which are sold principally to foodservice, food manufacturing, and industrial customers." The three principal components of the segment are Lamb Weston, a leading worldwide supplier of frozen potato products to restaurant chains and other customers; ConAgra Mills, one of the largest U.S. flour millers; and Gilroy Foods, which produces seasonings, flavors and vegetable products for industrial customers. Commercial Foods appears to be benefiting rather than suffering from inflation, inasmuch as sales and operating profits in the past 12 months showed increases of 26% and 21%, respectively.

Management is clearly bullish on prospects for the balance of the May 2009 fiscal year, based on the recent further pricing actions, as well as easy comparisons, and continuing benefits from the recent divestiture, including lower interest expense and a further decline in shares outstanding as a result of buybacks. Following the divestiture, for which CAG received \$2.3 billion in cash and \$550 million of payment-in-kind debt securities, the company paid down its commercial paper borrowings by \$1.1 billion, and repurchased 38.4 million shares (8% of the total outstanding) for \$900 million. It intends to buy additional shares later in the fiscal year.

As discussed, we believe a further easing of cost inflation could be an added benefit to F2009 earnings if recent trends continue. In addition, F2009 will include an extra 53rd week in May. The company has reduced its EPS guidance from \$1.56-\$1.59 in June to "slightly above \$1.50." Nevertheless, after a slow first quarter, that implies EPS of \$1.25 over the balance of the year, versus \$0.84 a year ago, up 49% for the final nine months. That would represent an exceptionally strong head-start for the "new" ConAgra Foods.

Table 2: (Continued) (a)

	F2009	F2008	F2007 Restated	F2007	F2006	F2005
Feb. - Net Sales:						
Consumer Foods		\$1,921.1	\$1,777.7	\$1,773.2	\$1,793.7	\$1,763.6
Commercial Foods		1,034.2	837.4	851.9	789.8	733.4
Total		\$2,955.3	\$2,615.1	\$2,625.1	\$2,583.5	\$2,497.0
		+8%	+24%	(1)%	+2%	+2%
		+24%	+13%	+8	+8	+8
		+13%		+2%	+3%	+3%
Operating Profit:						
Consumer Foods		\$232.3	\$307.6	\$308.1	\$275.5	\$271.9
Commercial Foods		144.6	108.7	109.3	80.2	76.9
Segment Total		\$376.9	\$416.3	\$417.4	\$355.7	\$348.8
General Corp. Expense		82.1	90.1	90.9	97.6	93.8
Company Total		\$294.8	\$326.2	\$326.5	\$258.1	\$255.0
		(24)%	(10)%	+12%	+1%	+1%
		+33		+36	+4	+4
		(9)		+17	+2	+2
		(9)		(7)	+4	+4
		(10)%		+27%	+1%	+1%
Operating Margin:						
Consumer Foods		12.1%	17.3%	17.4%	15.4%	15.4%
Commercial Foods		14.0	13.0	12.8	10.2	10.5
Segment Total		12.8	15.9	15.9	13.8	14.0
General Corp. Expense		(2.8)	(3.4)	(3.5)	(3.8)	(3.8)
Company Total		10.0%	12.5%	12.4%	10.0%	10.2%
		+7%		-	(2)%	(2)%
		+32		+11%	+6	+6
		+15%		+3%	+1%	+1%
May - Net Sales:						
Consumer Foods		\$1,889.3	\$1,767.7	\$1,760.7	\$1,762.5	\$1,797.5
Commercial Foods		1,188.8	897.6	912.6	823.0	774.0
Total		\$3,078.1	\$2,665.3	\$2,673.3	\$2,585.5	\$2,571.5
		(4)%		(23)%	+14%	+14%
		+9		+5	+26	+26
		+1		(15)	+17	+17
		(34)		(45)	+3	+3
		+41%		(44)%	+25%	+25%
Operating Profit:						
Consumer Foods		\$194.4	\$201.6	\$201.9	\$263.7	\$231.1
Commercial Foods		114.7	104.8	105.0	100.1	79.6
Segment Total		\$309.1	\$306.4	\$306.9	\$363.8	\$310.7
General Corp. Expense		108.6	164.4	169.0	116.7	112.8
Company Total		\$200.5	\$142.0	\$137.9	\$247.1	\$197.9
		10.3%	11.4%	11.5%	15.0%	12.9%
		9.6	11.7	11.5	12.2	10.3
		10.0	11.5	11.5	14.1	12.1
		(3.5)	(6.2)	(6.3)	(4.5)	(4.4)
		6.5%	5.3%	5.2%	9.6%	7.7%

(a) Continuing operations, excluding divested Trading and Merchandising operations. Excludes nonrecurring gains and charges.

Table 3: (Continued)

	F2009		F2008		F2007	
	Brands Growing	Brands Declining	Brands Growing	Brands Declining	Brands Growing	Brands Declining
February:	ACT II Banquet Blue Bonnet Egg Beaters Healthy Choice Hebrew National Hunt's Libby's Manwich Marie Callender's Orville Redenbacher's PAM Rosarita Ro*Tel Slim Jim Swiss Miss Wesson	ACT II Banquet Crunch 'n Munch Kid Cuisine Parkay Pemmican Reddi-wip Snack Pack Wolf	ACT II Banquet Crunch 'n Munch Kid Cuisine Parkay Pemmican Reddi-wip Snack Pack Wolf	ACT II Banquet Crunch 'n Munch Kid Cuisine Parkay Pemmican Reddi-wip Snack Pack Wolf	Blue Bonnet Chef Boyardee DAVID Egg Beaters Hebrew National Hunt's Marie Callender's Manwich Orville Redenbacher's PAM Rosarita Ro*Tel Snack Pack Wolf VanCamp's	ACT II Banquet Healthy Choice Kid Cuisine LaChoy Libby's Parkay Reddi-wip
May:	Andy Capp Blue Bonnet Chef Boyardee Crunch 'n Munch DAVID Egg Beaters Hebrew National Hunt's Libby's Manwich Orville Redenbacher's Rosarita Ro*Tel Snack Pack Wesson Wolf	ACT II Banquet Kid Cuisine Marie Callender's PAM Parkay Pemmican Reddi-wip Slim Jim Swiss Miss	ACT II Banquet Kid Cuisine Marie Callender's PAM Parkay Pemmican Reddi-wip Slim Jim Swiss Miss	ACT II Banquet Kid Cuisine Marie Callender's PAM Parkay Pemmican Reddi-wip Slim Jim Swiss Miss	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 Swiss Miss Wesson	ACT II LaChoy Parkay Ro*Tel VanCamp's Wolf

(a) Sales for Healthy Choice, Kid Cuisine and PAM were in line with prior-year amounts.
 (b) Sales for Slim Jim and Wesson were in line with prior-year amounts.
 (c) Sales for Hunt's, PAM, Healthy Choice and Banquet were in line with prior-year amounts.

Table 4: Commodity Prices - Monthly Averages, 2006-2008 (a)

	Corn		Soybeans		Wheat		Milk	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
January	\$4.52	\$3.65	\$11.95	\$6.59	\$9.60	\$5.21	\$18.92	\$13.36
February	4.94	3.94	13.43	7.26	11.77	5.37	18.04	14.32
March	5.13	3.75	12.76	7.21	11.85*	5.30	17.76	14.96
April	5.59	3.40	12.77	6.97	10.10	5.54	16.76	13.50
May	5.60	3.51	12.72	7.29	8.94	5.43	19.04	17.54
June	6.66*	3.80	14.90	7.77	9.19	6.16	20.18*	20.11
July	6.10	3.08	15.12*	7.99	8.58	6.30	18.34	21.17*
August	5.22	3.07	12.93	7.73	8.63	6.63	17.46	19.86
September	4.95	3.17	11.54	8.79	7.50	8.18	16.14	20.12
October		3.25		9.30		8.71		18.42
November		3.64		10.10		8.42		19.19
December		4.07*		11.14*		9.49*		19.95
				6.41*		5.38		13.47*

(a) Corn - Central Illinois, Bushel; Soybeans - Central Illinois, Bushel; Wheat - Kansas City, Hard Red Winter, Bushel;

Milk - Class III, CME Spot MO, Hundredweight.

* Annual peak.

Source: Doane's Agricultural Report.

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; 7/17/07 (\$27) – Strong Buy – Target \$31-\$32; 9/26/07 (\$25.50) – Strong Buy – Target \$31-\$32; 1/7/08 (\$23.15) – Strong Buy – Target \$29-\$30; 4/3/2008 (\$24.20) – Strong Buy – Target \$29-\$30; 7/16/2008 (\$21) – Strong Buy – Target \$29-\$30.

Important Disclosures

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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*	63%	0%
Hold	37%	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.

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