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COMPANY SUMMARY

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Speaker: Bob Cummins

Food Industry Comment:

ConAgra Foods (CAG-\$29.30) last week reported favorable results for F2Q (November), despite the cost pressures that have affected the entire food industry. Sales showed particularly strong growth of 8% (9% for consumer foods alone) for the second consecutive quarter, the largest increase among all the major food companies, reflecting CAG's increased effectiveness in sales and marketing. Despite some margin pressure on the consumer side, overall operating profits rose 10% with help from the foodservice and ingredient segments. EPS increased just over 4% (\$0.47 versus \$0.45), but would have been up 9% had it not been for an unusual \$0.02 noncash expense resulting from the termination of an interest rate swap. First-half EPS were \$0.74 versus \$0.68, up 9%. We expect accelerated earnings progress in the second half, as healthy sales growth continues and the increasing benefits of price increases and efficiency programs lead to a widening of profit margins. We are pleased with ConAgra's progress, and believe the strategies now in place will lead to increasing recognition as one of the most rapidly improving companies in the food industry. Rated "1" (Strong Buy), 12-month target price \$34-\$35, up from \$32-\$33 previously.

This was the first quarter since F2002 in which all three of ConAgra's business segments achieved year-to-year growth in operating profit. As mentioned, the largest, **Retail Products** (59% of sales, 66% of profits), with annual sales of \$8.7 billion, posted an impressive 9% increase in sales, continuing the trend of the prior period. That reflected healthy 7% growth in unit volume as well as higher prices. Management notes that its top 30 consumer brands, which represent nearly 80% of segment sales, showed a combined sales increase of 8%, achieving higher volume and market share across all major retail channels. Five brands, Banquet, Chef Boyardee, Egg Beaters, Marie Callender's, and PAM, have shown double-digit sales growth for several successive quarters. Among other leading CAG brands, Act II, Armour, Blue Bonnet, Cook's, DAVID, Eckrich, Hunt's, Kid Cuisine, La Choy, Orville Redenbacher's, Parkay, Peter Pan, Reddi-wip, Snack Pack, Swiss Miss, Van Camp's, and Wesson also achieved higher sales in F2Q, with many showing double-digit growth.

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See pages 4 and 5 of report for important disclosures and Analyst's Certification.

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Operating profit growth for Retail Products in F2Q lagged the 9% sales increase, with a 5% gain, as the segment's margin declined 70 basis points to 15.1%, reflecting higher input costs and a less favorable product mix. We expect higher margins and stronger profit trends in the second half, reflecting the full impact of the recent price increases as well as operational improvements.

Foodservice Products (24% of sales, 18% of profits), with annual sales of \$3.7 billion, is the nation's largest broadline supplier of food products to the restaurant industry, selling directly to the major chains as well as to foodservice distributors. The largest of its three business units, Culinary Products, markets a wide range of food items, including pizza, sauces, frozen foods, and processed meats, many of which are similar to CAG's retail brands. Specialty Potato Products (Lamb-Weston) is the leading supplier of french fries to restaurant chains both in the U.S. and abroad, while Seafood Products is an important marketer of shrimp and other seafoods. Sales in the foodservice segment declined 2% in F2Q, reflecting several divestitures and disruptions in the shrimp market following the imposition of quotas on imports. However, operating profits rose 6% and management looks for a strengthening of results in the second half.

At a recent Shields-sponsored luncheon for ConAgra Foods management in New York, we had an opportunity to meet not only with Bruce Rohde, ConAgra's Chairman, CEO and President, but also with two key operating executives, both of whom were appointed to their present positions during F2004: Dennis O'Brien, President and Chief Operating Officer of ConAgra Foods Retail Products, who was previously with Nestle, Campbell Soup and International Home Foods, and Allan Lutz, who joined the company last year from Nestle, and is President and Chief Operating Officer, ConAgra Foodservice. Both are experienced food industry executives with distinguished records, and both are actively leading the company's efforts to reorganize along more efficient lines, and thereby enhance both top-line growth and profit margins. CAG has virtually completed its divestiture program, and is well along in strengthening the performance of its research and development and logistics systems, its sales force, and its customer service (i.e., relations with retailers). It has made good progress in recruiting talented personnel from other packaged foods companies, but still sees further opportunities. On the other hand, in the view of CEO Rohde, a great deal remains to be done in upgrading CAG's information systems, its marketing efforts and its manufacturing efficiency. On the foodservice side, the seafood and potato businesses have always been efficient, freestanding operations, but the present culinary unit is an amalgamation of five previously independent companies, and still has significant opportunities to increase efficiency and exploit growth potential, including the adaptation of additional CAG products for the foodservice market.

The third business segment, **Food Ingredients** (17% of sales, 16% of profits), is a \$2.5 billion a year operation that includes ConAgra's original business, flour milling, as well as the processing of other grains, the manufacture of seasonings and flavors, and commodity trading and merchandising activities. A portion of its output is used in-house by CAG's other businesses,

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while outside customers include a wide range of other food manufacturers. It tends to be the most volatile of the three segments, both because its own manufacturing operations are subject to competitive and commodity-related influences, and because, as in the stock market, profits from trading can fluctuate widely. Volatility in the commodity markets over the past four quarters has led to strong trading profits, and resulting year-to-year segment earnings increases of 46%-115%. Trading profits accounted for more than half of the \$79 million of Food Ingredients segment income in F2Q, and for \$19 million of the \$25 million increase over a year earlier. That rate of earning power is not sustainable indefinitely. On the other hand, profits in the seasonings division have been depressed due to industry conditions, and an eventual recovery there could help to offset any dropoff in trading gains.

During F2004, ConAgra received just over \$1 billion in cash as a result of divestitures, and in effect used the funds to repay \$515 million of long-term debt and to repurchase \$419 million worth of common stock. Thus far in F2005, including transactions in December, past divestitures have generated another \$620 million, while the company has paid off an additional \$900 million of debt, as well as spending another \$181 million on share buybacks in F1Q. After selling 10 million of its Pilgrim's Pride shares early this month, it still owns another 15.4 million, with a current value of \$476 million. In view of its emphasis on debt retirement, as well as an expected \$123 million increase in capital expenditures this year (to \$475 million), we do not expect to see a resumption of the share buyback program until F4Q at the earliest. We estimate total debt net of cash as of 12/30/04 at \$4.4 billion, compared with \$5.1 billion in May 2004, and \$5.5 billion in May 2003.

ConAgra Foods is already a large and successful packaged-foods company. With annual U.S. consumer branded food sales alone of \$8.7 billion, and total food sales of \$12.4 billion, including foodservice, it is America's second largest food company, after Kraft. It has many well recognized and respected brands, two-thirds of which rank first or second in their categories. Nevertheless, we remain confident that management's strategies will make it an even stronger, more profitable company over time, resulting in increased recognition by investors, and attractive appreciation for its shareholders.

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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.

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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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