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**MARCH 4, 2005**

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## **COMPANY SUMMARY**

### **Friday, March 4, 2005**

**Speaker: Bob Cummins**

**Food Industry Comment:**

**ConAgra Foods (CAG-\$28)**  
**Del Monte Foods (DLM-\$11)**  
**General Mills (GIS-\$52)**  
**PepsiCo (PEP-\$54)**  
**Sara Lee (SLE-\$22.50)**  
**J.M. Smucker (SJM-\$51)**

These six companies, all of which are on our recommended list, were among the 29 food, beverage, tobacco and household products companies that made presentations last week at the annual Consumer Analyst Group (CAGNY) conference in Scottsdale, Arizona. The comments below summarize our current investment views on each stock, based in part on their discussions at the conference, as well as other recent contacts.

**ConAgra Foods** CEO Bruce Rohde and the President of Retail Products, Dennis O'Brien, reviewed the company's progress in implementing its strategy to become a highly focused, efficient brand-name food marketer, in contrast to its past profile as a decentralized, widely diversified food industry conglomerate. That program is well under way, and is already evident in an acceleration of top-line growth, with consumer food sales up over 9% for the six months ended November, well in excess of the growth rates for most other food companies. We remain confident that profitability will increase significantly as CAG continues to strengthen its performance in the areas of sales, marketing, customer relations, manufacturing, distribution, research and development, information systems, and recruiting over the next one to two years.

Unfortunately, the discussion of the company's impressive transformation was somewhat overshadowed by new CFO Frank Sklarsky's announcement that EPS will be negatively affected by \$0.10 in the February quarter, and by a lesser amount in the May period, by higher than expected raw material costs in CAG's processed meat operations, temporary production issues due to manufacturing plant consolidations, and startup inefficiencies during the implementation

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**See pages 8 to 12 of report for important disclosures and Analyst's Certification.**

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of a new information program. Investors rightly judged that these are clearly short-term rather than long-term issues, inasmuch as the stock, after declining 8% on the news, has now recovered most of the lost ground.

We are reemphasizing our Strong Buy ("1") recommendation on ConAgra, based on our belief that it is the most rapidly improving company in the food industry, and that it will gain recognition over time as one of the premier companies in the field, with astute management, a wide array of strong brands, above-average sales and earnings growth, high margins and rates of return, and strong cash flow. Despite the rally from their recent low, the shares remain 7% below their January high, while the dividend yield is nearly 4%, the highest in the food industry. Our 12-month target price is \$34-\$35. Recent comments: 9/24, 12/31/04.

**Del Monte Foods** in the two years since it acquired Heinz's U.S. pet food, tunafish, soup and baby food operations has done an outstanding job of integrating, strengthening and rejuvenating those businesses, as well as reducing and refinancing its debt. However, as discussed by CEO Rick Wolford and CFO Dave Meyers both at the conference and on DLM's March 3<sup>rd</sup> earnings conference call, the benefits have been offset by the inflationary cost pressures in ingredients, packaging, energy and transportation that have plagued all of the food companies to varying degrees. Thus, despite price increases on most product lines (averaging 3% across the company), EPS from operations for the year just ending will fall slightly short of last year's \$0.89, which included an extra week. Moreover, while some costs have abated, others are still rising, and although not providing specific guidance, management clearly expects F2006 to be another challenging year.

While obviously disappointing, especially in view of management's impressive accomplishments since the acquisition, this news does not change our positive view of the company and its long-term prospects. Moreover, the low valuation more than discounts the prospect of another relatively flat year. Based on a tentative \$0.90 estimate (significantly below DLM's true earning power) for the April 2006 fiscal year, the multiple is a meager 12.2 times, well below any other company we follow, and a 31% discount to the average stock in our food universe. It should be noted that the company intends to continue raising prices where it sees opportunities to do so, and that if the costs of oil, steel, trucking and other inputs remain at the present inflated levels, they will ultimately be fully reflected in the price structure for this and other food companies.

Besides managing its businesses effectively, DLM also continues to generate \$185-\$200 million of excess cash per year, which it is using to pay down debt. In an important financial development, the company recently refinanced its debt, retiring about \$300 million of 9 ¼% notes and replacing them with \$250 million of new notes paying 6 ¾%, while establishing a new credit facility that will provide increased borrowing power, reduced interest spreads on its floating rate debt, and improved flexibility. The early retirement of the notes will result in an \$0.11 charge in the April quarter, which as a nonrecurring item is not reflected in our \$0.85

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estimate for F2005. As a result of debt repayment and refinancing, the company is approaching investment-grade status, although management does not expect an upgrade of its credit ratings in the near future. In view of its improving finances, DLM is giving increased consideration to establishing its first cash dividend, which we believe would strengthen its image among investors. The initiation of a share repurchase program is also a possibility.

While patience may be required, we continue to have confidence in Del Monte's businesses and its management, and believe purchases during this period of disappointment will ultimately be rewarded by significantly higher earnings as well as a more generous P/E ratio. We are reemphasizing our "1" (Strong Buy) rating, and maintaining our 12-month target price of \$13-\$14. Recent comments: 9/14, 12/3/04.

**General Mills'** earnings record since the November 2001 acquisition of Pillsbury has been generally disappointing, in view of the sizable savings achieved by combining the two companies, as well as management's confidence at the time that it could accelerate the growth of the PSY operations. Among other factors, results have been affected by the weak performance of some PSY brands and business units, significant cost increases for ingredients, packaging, energy and transportation, and the impact of low-carb diets on consumption of grain-based foods. The share price over much of the past three years languished in the mid-40s. However, we see increasing evidence that the company has turned the corner, and that the better than expected 16% gain in EPS in the November quarter signals better times ahead.

At the conference, CEO Steve Sanger, Vice Chairman Steve Demeritt, and Executive Vice President Ken Powell discussed the company's current performance and its strategies for the future. Importantly, GIS's strong growth in F2Q was largely Pillsbury-related, including a long-awaited upturn in the large and highly profitable retail refrigerated dough line, strong growth for Pillsbury and Totino's frozen foods, Old El Paso, and Green Giant in the U.S., and for ex-PSY products overseas, as well as encouraging signs of improvement in the Bakeries and Foodservice segment. That business currently accounts for 15% of sales but only 6% of profits, but management believes it has significant recovery potential now that corrective actions have been taken. Management expects to report strong EPS for the company as a whole for the February quarter, against weak earnings a year ago, when costs were accelerating and the low-carb phenomenon was at its peak. The U.S. Retail profit margin showed an uptick in F2Q, after three straight quarters of year-to-year declines, and that trend should continue, in view of increased prices, productivity gains, and an easing of inflation pressures, particularly for agricultural commodities. Continued debt reduction will also contribute to earnings growth. GIS paid off \$572 million of debt in F2004, and expects to repay almost \$1.4 billion in F2005, including the proceeds from the recent sale of its interest in Snack Ventures Europe, resulting in a reduction of 22% over the two-year period. On balance, it appears that F2006 could be a year of accelerating earnings growth, although management is not making any forecasts as yet.

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In addition to improving fundamentals, the stronger performance of the GIS shares over recent months most likely reflects Diageo's sale of 50 million shares last October, of which 16.5 million were repurchased by the company. GIS has a call option on the remaining 29 million shares owned by DIA, and plans to exercise that option in October, call its zero coupon convertible debentures, and deliver the shares to the debenture holders in lieu of cash.

Although the current share price is 22% above the October low, it is only back to its range in early January, 2002, soon after the PSY acquisition, while the Dow Jones Industrials are 9% above their level at that time. Based on a tentative calendar 2005 EPS estimate of \$3.16, the multiple is 16.5, compared with a food group average of 18.3. Based on rising earnings momentum, and our view of GIS as one of the best managed, most innovative companies in the food industry, we reiterate our "1" (Strong Buy) rating, and are raising our target price from \$57-\$58 to \$60-\$61. Recent comments: 10/8, 12/28/04.

**PepsiCo** was represented at this year's conference by Irene Rosenfeld, CEO of Frito-Lay North America, PEP's largest profit center (33% of sales, 39% of operating profits), and one of the best managed and most profitable businesses in the food industry, with a 25.0% margin in 2004, up 22 basis points from 2003. The gradual slowing of growth for the overall salty snack market, and Frito's already dominant 65% share, are challenges for management, but the company has responded by redefining its market as "macrosnacks," where its share is only 15%. The 2001 addition of the Quaker snack brand, with its healthy image, was a plus in that regard.

Frito-Lay has long been recognized for its talents in product innovation, advertising and marketing, and efficient manufacturing and distribution. Consumer interest in new flavors, healthier ingredients and weight control creates opportunities for new products. The company is testing a new line called Sun Snacks for sale through retail chains featuring natural and organic foods. Typically, new products carry higher margins than the established lines, but in a contrary move, aimed at health-conscious consumers, in the past year Frito-Lay eliminated trans-fats in all of its products by switching to higher-cost corn oil. Besides developing successful new products, the company has shown a talent for reinvigorating older brands through changes in the marketing approach. For example, Lay's Classic potato chips, one of its oldest products, achieved a 9% sales increase last year.

Frito-Lay's ability to maintain healthy earnings growth despite slow growth in the overall market and a sometimes challenging environment is illustrated by its performance in 2004. Unit volume increased 3%, as the company gained nearly one percentage point in market share. Dollar revenues grew 5%, as a result of selective price increases and a favorable product mix. Despite higher costs for ingredients, packaging, and energy, the division operating profit increased 7%, including benefits from the company's ongoing productivity programs. Moderating commodity price inflation and the completion of the trans-fat switch suggest that profit growth could accelerate in 2005, although a 50% increase in media expenditures will be a partial offset.

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The strong performance of Frito-Lay over the years is indicative of PepsiCo's stellar management, and its stature as one of the premier growth companies in the consumer goods field. As such, it deserves a place in the portfolios of conservative growth-oriented investors. Rated "1" (Strong Buy), 12-month target \$62-\$63. Recent comments: 10/1/04, 2/9/05.

**Sara Lee** – For many in the audience, this was the first opportunity to meet SLE's new CEO, Brenda Barnes, who along with CFO Theo de Kool provided additional details on the company's major spinoff, divestiture and restructuring plan, first announced on February 10<sup>th</sup>. Briefly, the plan anticipates the sale of the European apparel and meat businesses, the U.S. retail coffee business (except for the Senseo brand), and the worldwide direct selling operations within the next 12 months, and the spinoff of the U.S. apparel subsidiary to shareholders by F1Q-07 (July-September, 2006). It further calls for a reorganization of the remaining operations into three segments, Food & Beverage, Foodservice, and International, with management of the two U.S. segments centralized at a new corporate headquarters location in the Chicago area. These three new segments on a combined basis are projected to achieve an operating margin of at least 12% of sales by 2010, versus a pro forma 8% today, through increased efficiency and an improving product mix. Included in the five-year plan is a \$250 million increase in annual media advertising and promotion and R&D expenditures.

Many of the intricacies of the program remain to be spelled out, such as how much debt the new apparel company will take on, what annual dividend each of the two emerging companies will pay, and what the likely proceeds from the divestiture may be (we estimate that it could be well into the billions). It also has yet to be determined which of the businesses being spun off or sold will be classified as discontinued operations for reporting purposes, an accounting treatment that would allow analysts to track the performance of the ongoing Sara Lee activities more closely.

On the financial side, a significant portion of the proceeds from the business dispositions will be used to reduce debt. In the presentation, management projected total debt at the end of F2010 at \$1.5-\$2 billion, compared with \$4.8 billion at January 1, 2005, but it is not clear how much of that decline will reflect funds from the divestitures and how much will come from cash flow. The planned divestitures (excluding U.S. apparel) are expected to result in a pretax gain of \$750 million. The reorganization of the ongoing company will necessitate one-time charges totalling about \$1 billion (half cash, half noncash), mostly in the first three years, but is expected to result in annual savings of \$575-\$810 million once it is fully implemented.

While management's plans for the restructured Sara Lee are clearly ambitious, if they are successful they will undoubtedly result in a more focused, more profitable, and faster-growing company, adding significantly to shareholder value. We are also intrigued by the market potential for the new apparel company, a well-managed \$4.8 billion a year entity with strong brands and efficient operations that may well gain more respect from investors once it is publicly owned. SLE at present trades at 12.8 times estimated calendar 2005 EPS, the lowest multiple

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among the leading packaged-foods issues, which average 18.3 times. We believe that post-spinoff, the new apparel company on its own could well trade at the present SLE multiple, while the ongoing SLE as it proves itself could rise to a valuation more in line with the rest of the food group. We reemphasize our "1" (Strong Buy) rating, and our recently-increased \$29-\$30 target price. Recent comments: 10/8, 10/29/04, 1/28, 2/14/05.

**Smucker** reported its results for F3Q (January) on February 18<sup>th</sup>, the last business day before the CAGNY conference. Co-CEOs Tim and Richard Smucker presented the company's story to an overflow crowd on the first day of the conference, and the stock price has been rising ever since. That performance, we believe, is attributable both to SJM's favorable business trends and prospects, and to a growing perception of the company as an attractive investment idea, a view with which we agree.

EPS from operations for F3Q of \$0.70 versus \$0.65, up 8%, were in line with expectations. However, it is important to recognize that this year's quarter included \$0.07 of startup costs at the new Uncrustables plant in Kentucky, which has taken longer than expected to reach targeted operational levels, but appears to be making good progress with respect to both efficiency and output. Excluding that expense, EPS would have been \$0.77, up 18%. We were particularly pleased by two aspects of the quarterly report: (1) In addition to good growth for the Smucker's and Jif brands, Crisco sales increased by a healthy 6%, after three straight quarters of declines caused by competitive activity and difficult prior-year comparisons. (2) The International Multifoods businesses, acquired last June, performed well in this, their peak quarter for the year, adding to our confidence that like the P&G deal three years ago, IMC too will prove to be a highly rewarding acquisition.

Management reiterated its F2005 expectation of 8% EPS growth off the prior year's \$2.40 from continuing operations. That implies \$2.59 for the year, and \$0.56 versus \$0.50, up 12%, for F4Q alone, including plant startup costs of \$0.04, down from \$0.07 in F3Q. We are particularly bullish on the earnings outlook for F2006, based on (1) the absence of this year's \$0.17 of startup expense, plus the opportunity to accelerate Uncrustables sales growth dramatically as the new plant reaches full production; and (2) synergistic benefits from the Multifoods acquisition, after a year in which cost savings have been fully reinvested in increased marketing expenditures. Our preliminary estimate is \$2.90, representing a gain of 12%.

While the SJM shares have gained 24% from last summer's low, and are approaching the all-time high reached last April after the announcement of the IMC merger, this continues to be one of our favorite investment ideas among the mid-cap food companies. We maintain our "1" (Strong Buy) rating, and are raising our 12-month target price from \$54-\$55 to \$56-\$57. Recent comments: 11/23/04, 1/14/05.

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**Table 1: FOOD STOCK SUMMARY - Prices, Earnings, Dividends**

	FY	Com. Shs. (mil.)	Price March 3 2005	Price Change		12 Mos. Range	Earnings Per Share			Cal. Year P/E		Ind. Divd.	Yield	Rating	12-Month Target
				2005 to Date	Cal. 2004		2004	2005E	2006E	2005E	2006E				
<b><u>Nine Leading Packaged-Foods Companies</u></b>															
Campbell Soup (CPB)	July	409.0	28	(6)%	+12%	31-25	\$1.58	\$1.68	\$1.81	16.2	15.1	\$0.68	2.4%	3	
ConAgra Foods (CAG) (c)	May	517.0	28	(5)	+12	30-25	1.49	1.46	1.67	18.2	16.0	1.09	3.9	1	34-35
General Mills (GIS)	May	379.0	52	+5	+10	54-43	2.85	2.95	3.30	16.5	14.9	1.24	2.4	1	60-61
Heinz (HNZ) (bc)	April	350.6	37	(4)	+7	41-35	2.20	2.25	2.55	15.2	13.6	1.14	3.1	1	44-45
Hershey Foods (HSY)		249.6	64	+15	+44	64-41	2.06	2.28	2.50	28.1	25.6	0.88	1.4	3	
Kellogg (K)		412.4	45	(1)	+17	46-38	2.14	2.30	2.48	19.6	18.1	1.01	2.2	3	
Kraft Foods (KFT)		1,707.0	34	(4)	+11	36-29	1.87	1.95	2.10	17.4	16.2	0.82	2.4	3	
PepsiCo (PEP)		1,727.0	54	+4	+12	56-47	2.32	2.60	2.85	20.8	18.9	0.92	1.7	1	62-63
Sara Lee (SLE)	June	790.0	22.5	(7)	+11	25-21	1.62	1.68	1.85 i	12.8	11.6	0.79	3.5	1	29-30
Average				0%	+13%					18.3	16.7		2.6%		
<b><u>Foodservice Distributors</u></b>															
Performance Food Group (PFGC)		46.5	27	+1	(26)	36-21	1.25 E	1.75 i	1.90 i	15.4	14.2	-	-	1	34-35
SYSCO (SYY)	June	638.2	35	(9)	+3	41-29	1.37	1.48	1.72	21.9	19.1	0.60	1.7	1	44-45
<b><u>Other Companies</u></b>															
Dean Foods (DF) (g)		155.9	35	+5	0	38-28	2.02	2.26 i	2.53 i	15.5	13.8	-	-	1	40-41
Del Monte Foods (DLM) (cd)	April	209.8	11	0	+6	12- 9	0.89	0.85	0.90	11.6	10.5	-	-	1	13-14
Flowers Foods (FLO) (cg)		44.7	30	(4)	+22	32-21	1.21	1.45	1.56	20.7	19.2	0.50	1.7	3	
Sensient Technologies (SXT)		46.6	23	(5)	+21	24-18	1.53	1.65	1.80	13.9	12.8	0.60	2.6	2	26-27
Smucker (SJM)	April	58.2	51	+8	+4	53-41	2.40	2.60	2.90	17.9	16.2	1.00	2.0	1	56-57
Shields Food Universe Average				(1)%	+9%					17.6	16.0		2.4% h		
<b>S&amp;P 500</b>			1210	0%	+9%		\$68.01	\$74.37	-	16.3	-	\$21.23	1.8%		

A Actual. E Estimated. (a) Diluted. Before nonrecurring charges or gains. (b) All figures adjusted for DLM spinoff. (c) Continuing operations. (d) EPS are pro forma for acquisition and related financing. (ne) No estimate. (g) Adjusted for split. (h) Excludes non-dividend paying companies. (i) Excludes impact of divestitures.

Ratings: 1- Strong Buy; 2-Buy; 3-Neutral; 4-Sell; NR-Not Rated.

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(FOOD STOCK SUMMARY TABLE 1.XLS/3/4/05)

**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 position in the shares of ConAgra Foods, Del Monte Foods, General Mills, PepsiCo, Sara Lee, and J.M. Smucker.

Other ConAgra Foods reports issued by me are: 3/26/04 (\$26.70) – Strong Buy – Target \$32-\$33; 5/18/04 (\$28) – Strong Buy – Target \$32-\$33; 6/4/04 (\$28) – Strong Buy – Target \$32-\$33; 7/2/04 (\$27) – Strong Buy – Target \$32-\$33; 9/24/04 (\$26) – Strong Buy – Target \$32-\$33; 12/14/04 (\$27) – Strong Buy – Target \$32-\$33; 12/31/04 (\$29.30) – Strong Buy – Target \$34-\$35.

Other Del Monte Foods reports issued by me are: 3/9/04 (\$11.10) – Strong Buy – Target \$14-\$15; 5/18/04 (\$11) – Strong Buy – Target \$14-\$15; 6/4/04 (\$10.50) – Strong Buy – Target \$14-\$15; 7/2/04 (\$10) – Strong Buy – Target \$14-\$15; 9/14/04 (\$10.90) – Strong Buy – Target \$14-\$15; 12/3/04 (\$10.40) – Strong Buy – Target \$13-\$14; 12/14/04 (\$10.20) – Strong Buy – Target \$13-\$14.

Other General Mills reports issued by me are: 2/27/04 (\$46) – Strong Buy – Target \$57-\$58; 3/19/04 (\$46.50) – Strong Buy – Target \$55-\$56; 5/18/04 (\$46) – Strong Buy – Target \$55-\$56; 6/4/04 (\$46) – Strong Buy – Target \$55-\$56; 10/8/04 (\$44.80) – Strong Buy – Target \$53-\$54; 12/14/04 (\$47) – Strong Buy – Target \$53-\$54; 12/28/04 (\$49.60) – Strong Buy – Target \$57-\$58.

Other PepsiCo reports issued by me are: 2/6/04 (\$50) – Strong Buy – Target \$56-\$57; 4/23/04 (\$54.60) – Strong Buy – Target \$60-\$61; 5/18/04 (\$54) – Strong Buy – Target \$60-\$61; 7/16/04 (\$52) – Strong Buy – Target \$60-\$61; 10/1/04 (\$49) – Strong Buy – Target \$60-\$61; 12/14/04 (\$51) – Strong Buy – Target \$60-\$61; 2/9/05 (\$55) – Strong Buy – Target \$62-\$63.

Other Sara Lee reports issued by me are: 1/23/04 (\$20.30) – Strong Buy – Target \$25-\$26; 2/27/04 (\$22) – Strong Buy – Target \$26-\$27; 4/27/04 (\$23.60) – Strong Buy – Target \$28-\$29; 5/18/04 (\$23) – Strong Buy – Target \$28-\$29; 8/20/04 (\$21.50) – Strong Buy – Target \$26-\$27; 10/8/04 (\$22.80) – Strong Buy – Target \$26-\$27; 10/29/04 (\$23) – Strong Buy – Target \$26-\$27; 12/14/04 (\$24) – Strong Buy – Target \$28-\$29; 1/28/05 (\$23.15) – Strong Buy – Target \$27-\$28; 2/14/05 (\$23.50) – Strong Buy – Target \$29-\$30.

Other J.M. Smucker reports issued by me are: 4/16/04 (\$51) – Buy – Target \$60-\$61; 5/18/04 (\$49) – Buy – Target \$60-\$61; 6/4/04 (\$49) – Buy – Target \$60-\$61; 6/25/04 (\$45) – Strong Buy – Target \$60-\$61; 7/27/04 (\$42.50) – Strong Buy – Target \$60-\$61; 11/23/04 (\$44) – Strong Buy – Target \$54-\$55; 12/14/04 (\$46) – Strong Buy – Target \$54-\$55; 1/14/05 (\$46) – Strong Buy – Target \$54-\$55.

## 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.

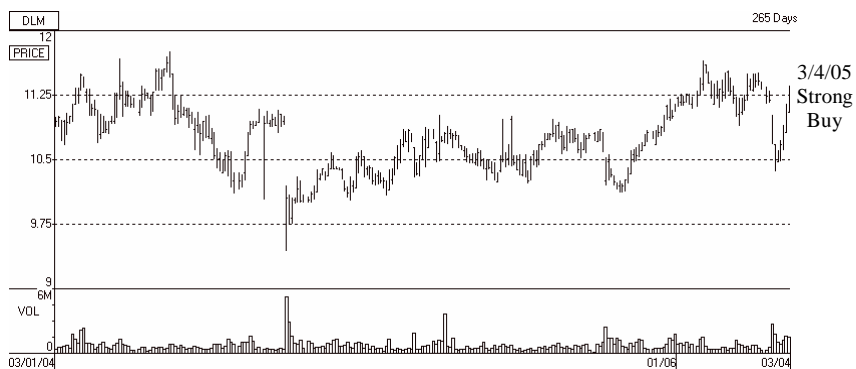
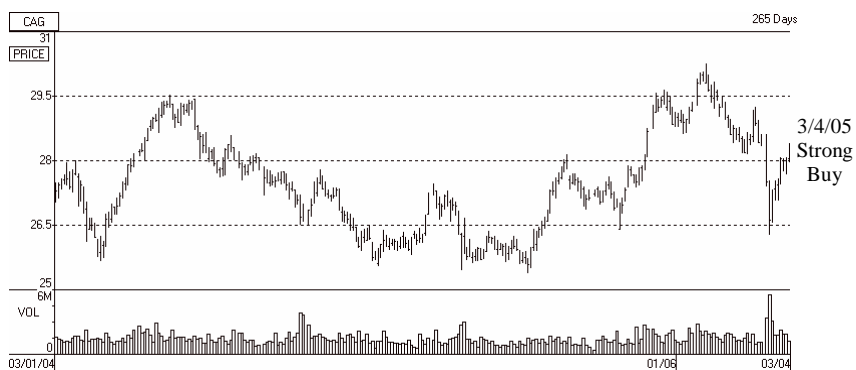
**Sell ("4").** The stock's total return is expected to be below the average total return of the analyst's industry coverage universe over the next 12 months.

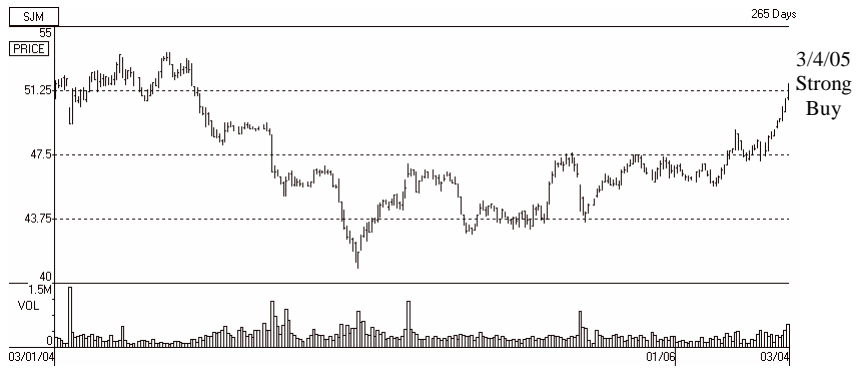
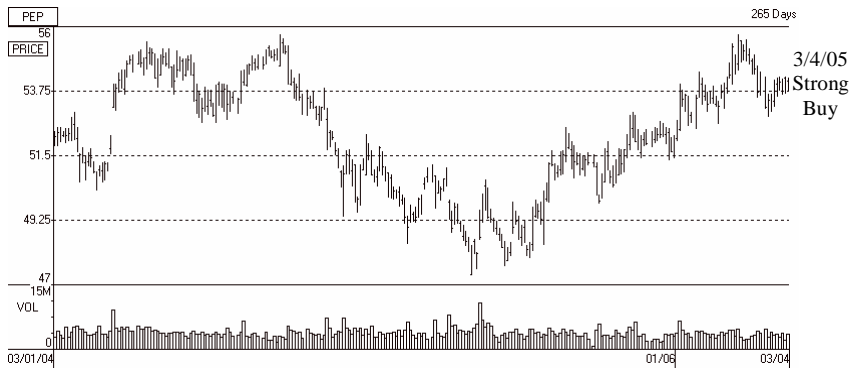
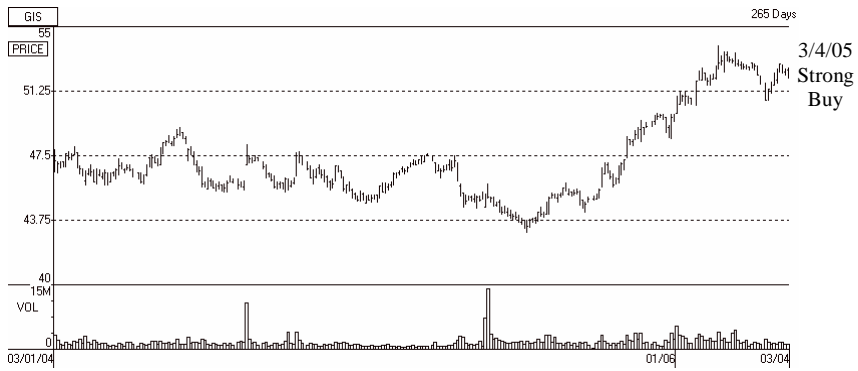
Unless otherwise specified, the time frame for price targets included in this report is 12 months.

Among the stocks we follow, 63% are rated Strong Buy, 6% Buy, 31% Neutral, and 0% Sell.

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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