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COMPANY SUMMARY
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Speaker: Bob Cummins

Food Industry Comment:

Dean Foods (DF-$35.40), the nation's leading dairy products processor and marketer, as expected, reported lower 2Q earnings, as aggressive pricing action was insufficient to offset extraordinary cost increases for raw milk and butterfat, which averaged 87% and 105% above 2Q-03 levels, respectively. EPS were at the low end of management's forecast range of $0.47-$0.50, and 16% below the record $0.56 of a year ago. We view that decline as modest considering the severe pressures on the company during the period, and a testimony to management's ability to deal effectively with adversity. Meanwhile, the company continued to pursue growth opportunities for its high-margin strategic brands, whose combined unit volume increased 16%. Milk prices have moderated recently, and management continues to expect a resumption of earnings growth in 3Q. Earnings for the year are projected at $2.21-$2.26, up 8%-10%, including $0.54-$0.57 (up 4%-10%) for 3Q, and $0.72-$0.76 (up 29%-36%) for 4Q. Our preliminary estimate for 2005 is $2.60. As growth resumes, we expect investors' confidence will strengthen. We continue to view Dean Foods as one of the most dynamic companies in the food industry, and reemphasize our "1" (Strong Buy) rating, as well as our 12-month target price of $41-$42.

The **Dairy Group**, Dean's largest business segment, and the one most vulnerable to commodity price changes, reported sales growth of 25% for 2Q. After adjusting for acquisitions and a slight decline in unit volume, we calculate that the company's average pricing for milk and other products was about 20% above a year ago, which is indicative of management's determination to maintain earnings during periods of cost inflation. Given the unusually severe cost pressures, it is not surprising in this instance that segment profits in 2Q did decline 11%. The operating margin narrowed to 6.8% from a record-high, and perhaps unsustainable, 9.5% last year, but was not far below the more typical 7%-8% of prior years, and still well above the margins of other dairy processors, even before the recent cost pressures. During July and August, market prices of both milk and butterfat have been declining, and at current levels they are down 19% and 13%, respectively, from their 3Q averages. If these trends continue, as seems likely, the lower costs will eventually be reflected in DF's selling prices, but we believe management's first priority will be to restore positive earnings comparisons and insure a recovery in profit margins.

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The **Branded Products Group**, Dean's major growth engine, is also affected by commodity costs, but to a lesser degree since it emphasizes proprietary, value-added products with intrinsically higher margins. Reported sales for the group increased 70% in 2Q, or 29% adjusted for acquisitions. Unit volume on a comparable basis rose 14%, while the strategic brands it most relies on for growth grew 16%, led by Silk soymilk, Horizon Organic products, and International Delight coffee creamers. Its other strategic brands, which include Sun Soy soymilk, Hershey's beverages, Land O' Lakes products, Marie's salad dressings, and Dean's dips, are also performing well, according to management. Despite continued growth in marketing expenditures, this segment reported a second consecutive quarter of strong profit gains, reflecting the Horizon acquisition in January, the end of management incentive payments to the former owners of White Wave (Silk), and depressed results a year ago. Thus, 2Q operating income of $17 million was more than five times that of 2Q-03. Another substantial profit rise is expected in 3Q, against an easy comparison, and management's bullish EPS forecast for 4Q is based in part on dramatic margin expansion for Branded Products in a quarter when its sales are always at a seasonal peak.

Specialty Foods, Dean's third segment, produces a wide variety of mainly private label food and beverage items for supermarket chains, other food retailers, and foodservice customers. Its largest product line is pickles, which account for half of its sales, and where it is the dominant private label producer, and second only to Vlasic in total volume. Other product lines include powdered coffee creamers, aseptic sauces and puddings, and nutritional beverages. It has efficient operations, and has been a good contributor to Dean's profits, with above-average margins in the 14%-17% range. However, it is characteristic of these businesses that in times like these, when the entire food industry is faced with cost inflation for commodities, packaging, and energy costs, it cannot raise prices immediately to maintain margins. In addition, the company recently lost an important customer for its beverage products. After a good year in 2003, earnings in 2004 have declined for two straight quarters, including a 26% decline in the latest period, on a modest 1% drop in sales. Results are likely to remain weak over the near term, but should eventually show a strong rebound from the current level, through a combination of price relief and an easing of cost pressures.

In conjunction with its August 4th earnings release, Dean Foods also announced plans to consolidate the three entities that comprise its Branded Products segment, White Wave, Horizon Organics, and the Dean National Brand Group, at a new headquarters in Boulder, Colorado, where White Wave and Horizon are already based. The combined businesses have annual revenues of $1.1 billion, a total that should rise substantially through further acquisitions and internal growth. Until now, they have been totally autonomous. Management believes the combination will result not only in significant cost savings, but also in more effective marketing programs and stronger relationships with its chain customers. The move is expected to be completed by the end of 2005.

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 Dean Foods. Other reports issued by me are: ConAgra Foods ($27) 7/2/04-Strong Buy; General Mills ($46) 6/4/04-Strong Buy; SYSCO Corporation ($39) 4/30/04-Strong Buy; Sara Lee ($23.60) 4/27/04-Strong Buy; Sensient Technologies ($22) 7/20/04 -Buy; Performance Food Group ($27) 6/25/04- Strong Buy; Dean Foods ($35) 5/7/04- Strong Buy; Heinz ($37) 5/25/04-Strong Buy; J.M. Smucker ($42.50) 7/28/04- Strong Buy; Del Monte Foods ($10) 7/2/04 - Strong Buy; PepsiCo ($52) 7/16/04 - Strong Buy.

Guide to Investment Ratings:

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.
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.

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