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COMPANY SUMMARY

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Speaker: Bob Cummins

Food Industry Comment:

Del Monte Foods (DLM-\$11.90) has had a busy month, beginning on March 2nd with the release of results for F3Q (January), and the simultaneous announcement of agreements to sell its private label soup and infant feeding businesses, and to acquire Meow Mix Holdings, the number two marketer of dry cat foods. It followed up on March 16th with an agreement to acquire Milk-Bone, a leader in dog snacks. The net effect of the three transactions will be to enhance growth potential by adding \$430 million of high-margin, brand-name sales in a dynamic field where DLM already has a major presence and a successful record, while eliminating \$295 million of profitable but lower-margin sales of predominantly non-branded products. Meanwhile, despite inflationary pressures, EPS continue to exceed expectations, and for F2006 to date are 8% above last year.

The recent strength in the DLM shares, in the face of a major increase in borrowings and likely confusing earnings reports over the next few quarters, appears to reflect confidence in the management, in the prospects for the existing businesses, and in the likelihood that the new additions will enhance future growth, a view with which we agree. Although trading at their highest price since June, 2002, when the Heinz deal was announced, the shares at 15 times trailing EPS of \$0.78 remain near the low end of the food industry range. We reiterate our "1" (Strong Buy) rating, and are raising our 12-month target price range from \$13-\$14 to \$14-\$15.

In its second consecutive year of severe cost inflation, driven by steel, energy, logistics and transportation, Del Monte has achieved respectable results by instituting selective price increases, emphasizing new value-added products, controlling expenses, and using its substantial free cash flow to reduce debt and buy back shares. For the nine months ended January, 2006, sales increased 4% (most of it attributable to pricing), on top of a 5% gain a year earlier. Consumer Products sales grew 5%, including 5% for the Del Monte lines, 3% for StarKist, and an impressive 14% for the smaller private-label soup business. Pet Products posted a 2% increase, after achieving double-digit growth in the same period of F2005.

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

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Profits, while satisfactory under the circumstances, did not perform as well. Consumer segment income declined 7%, reflecting not only cost pressures but also consumer resistance to higher prices, and thus reduced volume. The Pet segment largely made up for that, as its earnings rose 13%, reversing a prior-year decline. Thus, DLM's total segment profits for the first nine months were less than 1% below those of a year ago. A 13% decline in interest expense, reflecting the repayment and refinancing of debt, offset an unusually large rise in Corporate expense, and with the help of a slightly lower tax rate, net income before special items for the nine months to date increased 2%. The larger 8% rise in EPS (\$0.55 versus \$0.51) reflects the use of excess cash to repurchase nearly 6% of the company's shares last June. For the fourth quarter ending in April, management projects sales growth of 1%-3%, and EPS in the \$0.18-\$0.23 range, versus \$0.23 from operations a year ago, indicating earnings of \$0.73-\$0.78 for the year, compared with \$0.74 in F2005. We would not be surprised to see final results at the high end of that range, despite increased marketing expenditures in F4Q.

Ever since DLM unveiled its "Project Brand" strategy last June, it has been expected that it would eventually divest the former Heinz soup business, its largest non-branded operation. Although this division dominates its sector, and has achieved strong growth since its acquisition in 2002, its profits recently have been disappointing as a result of rising costs. It is a better fit for the buyer, TreeHouse Foods, which specializes in private-label products and has stated its intention to expand in that field. We believe the Nature's Goodness baby food business was included because it is a distant number three in its field, because it shares a manufacturing facility with soup, and perhaps because THS has other plans for it.

Management expects the sale to close by the end of April, and both businesses will be segregated as discontinued operations when DLM reports F2006 results in June, 2006. They are expected to account for \$0.09 of the estimated EPS of \$0.73-\$0.78 for the year, indicating EPS from continuing operations of \$0.64-\$0.69. After-tax proceeds of the sale are estimated at \$210 million, which we expect will initially be invested in short-term securities. Based on current commercial paper rates, that would indicate annualized income of about \$10 million, or \$0.03 per share after taxes. Ultimately, the funds will likely be applied against the cost of the two acquisitions, both of which are expected to close early in the 2007 fiscal year.

Meow Mix, which originally was part of Ralston Purina (now Nestle), is being acquired from a private equity firm for \$705 million, which includes \$23 million of tax benefits that DLM will receive after the transaction closes. Annual sales are \$250 million. The high multiple of sales reflects the attractive profit margins the business enjoys. Its gross margin exceeds 35% of sales, compared with just over 25% currently for DLM itself. We estimate its operating profit (EBIT) margin to be in the 17%-18% area, comparable to DLM's margin in its present pet food operations, and well above the 10% it earns in consumer foods. The dry cat food category is growing at 4% a year, and Meow Mix in the past three years has grown at a much faster 10% rate. DLM's management expects to achieve significant cost savings as Meow Mix is integrated with its existing operations.

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Milk-Bone for 100 years has been one of the best-recognized brands of dog snacks. It currently belongs to Kraft Foods, which is in the process of divesting a number of non-core businesses. The purchase price is \$580 million, which over time will be offset in part by tax benefits related to amortization of intangibles, with a present value of \$125 million. Annual sales are \$180 million, and profit margins are well above those of DLM overall. The dog snack category has been growing 10% a year, but Milk-Bone has lost market share, reflecting a lack of emphasis by KFT. Del Monte has a strong track record in pet snacks, and intends to increase Milk-Bone's marketing support to accelerate its growth.

The two acquisitions will increase the company's annual pet products sales from \$850 million to more than \$1.2 billion. Including the effect of the divestiture, DLM's sales of brand-name products overall will increase from 70% to 86% of sales. We calculate that pet products alone will increase in importance from 26% of sales and 39% of segment profits in F2006 to 40% and 52%, pro forma, which should enhance the valuation of the shares, in view of the higher margins and superior growth potential in that area.

Although the two new pet products businesses are unlikely to contribute materially if at all to DLM's sales and earnings in F1Q-07 (May-July), management expects that the combined impact of the divestiture and the two acquisitions on earnings for F2007 as a whole will be neutral, before one-time integration costs, which we expect will be clearly quantified. The first fiscal quarter is the seasonal low point for many of the company's product lines, and typically accounts for only 20% of annual sales and 8%-10% of EPS. Demand is particularly slow for soup, which is a cold weather product, with F1Q accounting for only about 15% of its annual sales. Thus, we doubt that the soon-to-be-sold private label soup and infant feeding businesses contributed materially to DLM's earnings of \$0.08 per share in last year's first quarter. Still, it is likely, in view of timing uncertainties and the substantial change in the business mix, that quarterly earnings comparisons will be irregular throughout F2007. Management expects the two acquisitions to be "meaningfully accretive" by F2008.

Since the completion of the Heinz acquisition in December, 2002, which tripled the size of the company, DLM has used much of its free cash flow to reduce debt, which now stands at \$1.2 billion, net of cash, down from \$1.6 billion immediately after that transaction. By comparison, the equity market capitalization is \$2.4 billion. While that is still a relatively large amount of debt for a company this size, interest expense was covered five times by EDITDA in the latest 12 months, and DLM is generating free cash flow from operations, net of capital expenditures and dividends, of \$200 million a year. With the completion of the three pending transactions, net borrowings will nearly double, to an estimated \$2.3 billion. On the other hand, EBITDA and free cash flow will also increase, and as in the past, excess cash will continue to be used primarily to reduce debt. As a result, management expects that the company's leverage ratios will be back to the present range within the next three years.

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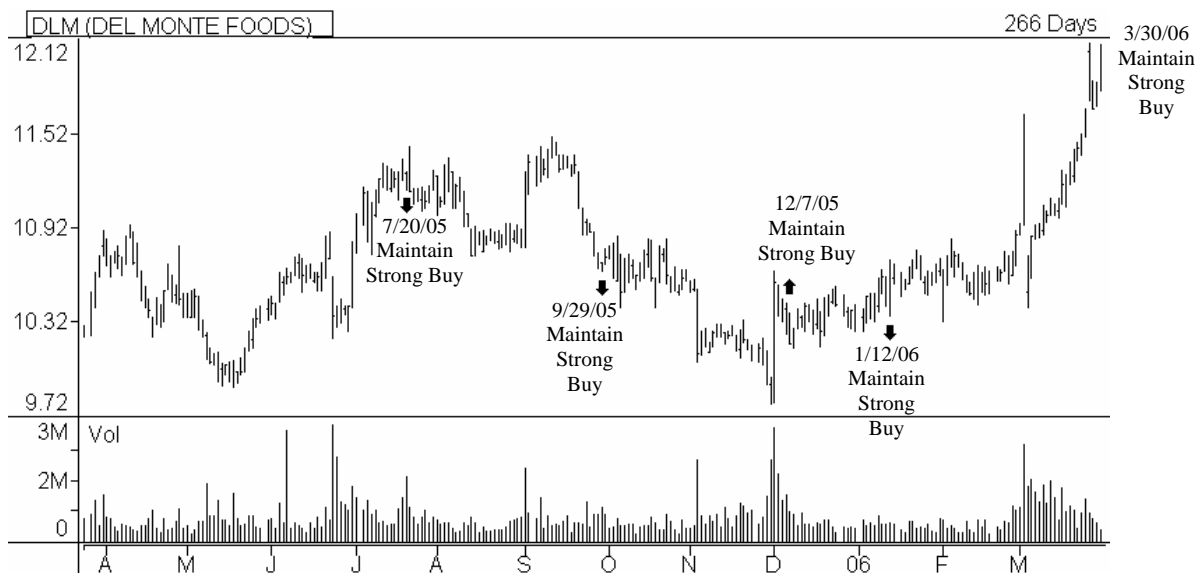
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