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## COMPANY SUMMARY

Wednesday, June 18, 2008

Speaker: Bob Cummins

**Rating: Strong Buy**

Food Industry Comment:

### Del Monte Foods (DLM-\$7.40)

	<u>F2007</u>	<u>F2008</u>	<u>F2009E</u>	<u>Dividend/ Yield</u>	<u>Shares Out. (mil.)</u>	<u>12-Mo. Range</u>	<u>12-Mo. Target</u>
EPS (a)	\$0.72	\$0.69	\$0.60	\$0.16	197.6	\$13-\$7.4	\$9-\$10
P/E	-	-	12.3x	2.2%			

(a) April fiscal years. Excludes nonrecurring gains and charges.

Del Monte on June 5<sup>th</sup> reported strong results for the fourth quarter of its April 2008 fiscal year, as sales showed a healthy 11% increase, and EPS excluding one-time items rose 23%, reflecting good cost controls, lower interest expense, and a 3% decline in shares outstanding, partly offset by a higher tax rate. Instead of rising on the news, the shares, which were already trading well below their 12-month high, have declined 18% to their lowest price since April, 2003, as investors focused on management's forecast for the year ahead. In view of continued inflationary cost pressures, particularly for food ingredients and energy, the seasonally slow July quarter will show a loss, and despite a more optimistic outlook for the balance of F2009, EPS for the year are expected to be down 10%-16% to only \$0.58-\$0.62, the lowest in many years.

While this news is obviously disappointing, it is more than reflected in the depressed stock price, in our view. We are encouraged by management's announcement that it is exploring a possible sale of DLM's troubled StarKist tunafish business. In our opinion, this could be a prelude to an eventual breakup or sale of the entire company. We are maintaining our "1" (Strong Buy) rating, believing that the shares have attractive recovery potential for venturesome investors.

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**See page 10 for Analyst's Certification, pages 10-11 for Important Disclosures and pages 11-12 for Other Disclosures and Disclaimers**

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All of the food companies have faced severe challenges over the past year as a result of unprecedented inflation in commodity prices, but Del Monte appears to have suffered more than most, reflecting either the nature of its businesses or management's failure to raise prices quickly enough to cover costs. For F2008 overall, sales showed an increase of more than 9%, to \$3.7 billion, including the impact of pricing, but operating income, excluding one-time items, declined 4%, as the operating margin narrowed by 140 basis points to only 9.6% of sales, the lowest since we have followed the company. EPS from operations declined by a similar 4%, to \$0.69 versus \$0.72, with lower interest expense offset by a higher effective tax rate of 34.1%.

The larger of DLM's two business segments, **Consumer Products** (62% of sales, 41% of earnings), registered 8% sales growth for the year, while its operating income rose 1% thanks to a strong fourth quarter. Its profit margin for F2008 as a whole narrowed to 7.2% from 7.7%, but the April period showed a healthy uptick after 13 consecutive quarters of year-to-year margin erosion. **Pet Products** (38% of sales, 59% of earnings) reported a 12% rise in sales, but its profits for the year declined 7%, reflecting year-to-year weakness in 2Q and 3Q. The pet business remains considerably more profitable than consumer foods, but its operating margin for the year declined by a substantial 340 basis points, to 17.0% of sales, versus 20.4% in F2007.

While results in the April quarter were gratifying, input costs have accelerated further since then, and it is clear that F2009 will be another challenging year, with cost increases expected to be in the double digits. The company has implemented further price increases to take effect in F1Q, and the strong results for Consumer Products in the April period partly reflect prebuying by customers. After two rounds of price increases for Pet Products in F2008, another rise will take effect this month. In both segments, the impact of pricing will continue to lag costs, but earnings will reflect accelerating benefits starting in the August-October quarter. Management expects that after an expected loss in F1Q, EPS for the final nine months will be roughly flat with those in F2008.

Besides raising prices to cover costs, DLM has taken several other steps to enhance the company's performance:

- In January, 2008, Nils Lommerin, who was previously Executive Vice President of Operations, was promoted to the new position of Chief Operating Officer, with supervisory responsibility for both the Consumer and the Pet segments. In May, the company announced the hiring of Bill Pearce, a seasoned marketing executive with previous experience at Coca-Cola, Miller Brewing, Procter & Gamble, Campbell Soup, and most recently Taco Bell, to be Senior Vice President and Chief Marketing Officer, also a new position. In conjunction with this appointment, DLM announced plans to relocate 100 marketing and other related positions from Pittsburgh to corporate headquarters in San Francisco, where all marketing functions will be centralized. It also announced that the Senior Vice Presidents in charge of Consumer Products and Pet Products would be leaving the company.

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- Also in May, DLM announced that “in response to published reports, it confirms that it is exploring strategic alternatives for the company’s seafood business, including a potential sale of the business.” StarKist, which was part of the Heinz transaction in December, 2002, prospered in the years following the acquisition. More recently, however, despite its leading position in the industry, its profits have suffered as it has been unable to pass on dramatically rising fish costs caused by a reduced catch, as well as the rising cost of fuel. Moreover, to the extent that prices have been raised, volume has suffered. The company does not break out tuna results, but we believe the operating margin is probably in the low single digits, below even the modest margin of the Consumer Products segment as a whole. We believe a sale of this business would be welcomed by investors.
- In conjunction with the yearend earnings report, management outlined a two-part strategic plan aimed at upgrading the company’s product mix and accelerating sales and earnings growth. First, it intends to focus both capital investment and consumer marketing expenditures on higher-margin businesses where the company has a strategic advantage and sees the potential for significantly higher profits. Two specific examples are packaged produce and pet products. Secondly, it has identified specific opportunities for increased innovation and productivity improvements. Included in the new strategic plan is a focus on continued pricing actions to strengthen profit margins. Management will provide further details on its strategies at an investor meeting in New York City on July 8<sup>th</sup>.

For some time, and especially in view of the 43% decline in its stock price from the July 2007 high of \$12.94, we have believed that DLM’s \$1.4 billion Pet Products business, one of the largest in that field, could make the company a potential target for a takeover, by either a strategic buyer or a private equity group. A divestiture of StarKist could help to facilitate such a development. This is an attractive industry, with above-average growth, and one that lends itself to innovation and consumer marketing. DLM has well-recognized brands, including Meow Mix and Milk-Bone, both acquired in F2007, as well as Kibbles ‘n Bits, 9Lives, Pup-Peroni, Snausages, Pounce, and Alley Cat. As mentioned, Pet Products in F2008 accounted for 38% of DLM’s sales, but 59% of its profits. At its peak in F2007, the division had an impressive 20.4% operating margin, and it could presumably recover to that level as pricing adjusts to present cost levels.

An example of a possible strategic buyer might be Kellogg, which was predominantly a breakfast cereal company until it acquired Keebler’s \$2 billion a year cookie and cracker business in 2001. Conceivably K might be ready to acquire another marketer of brand-name family-oriented, largely grain-based products, especially one with profit margins that are even higher than those of Kellogg itself. An added attraction of such a combination might be the opportunity to expand DLM’s products into overseas markets, using K’s well-established worldwide infrastructure.

**Table 1: Del Monte Foods Company - Quarterly Data (millions except EPS) (a)**

	F2008	F2007 (d)	F2006 Cont. Ops. (c)	F2006	F2005	F2004
<b>July</b>						
Net Sales	\$753.5	\$674.1	\$616.6	\$671.1	\$626.0	\$611.3
Cost of Products Sold	568.0	505.1	466.7	509.3	476.3	455.5
Gross Profit	185.5	169.1	149.9	161.8	149.7	155.8
SG&A Expenses	135.5	122.1	108.1	114.4	100.6	97.3
Operating Income	50.0	47.0	41.8	47.4	49.1	58.5
Interest Expense	38.0	30.5	21.2	21.2	24.6	30.0
Other Expense (Income)	0.6	0.3	-	-	2.0	0.8
Total	38.6	30.8	21.2	21.2	26.6	30.8
Income Before Taxes	11.4	16.2	20.6	26.2	22.5	27.7
Income Taxes	4.4	4.3	7.8	9.9	8.6	9.8
Net Income	\$7.0	\$11.9	\$12.8	\$16.3	\$13.9	\$17.9
				+17%	(22)%	
Diluted Shares	205.7	204.0	210.5	210.5	211.9	210.6
Earnings Per Share	\$0.03	\$0.06	\$0.06	\$0.08	\$0.06	\$0.09
				+33	(33)	
Gross Margin	24.6%	25.1%	24.3%	24.1%	23.9%	25.5%
SG&A/Sales	18.0	18.1	17.5	17.0	16.1	15.8
Operating Margin	6.6	7.0	6.8	7.1	7.8	9.7
Effective Tax Rate	38.6%	26.7%	37.9%	37.8%	38.2%	35.4%
<b>October</b>						
Net Sales	\$938.1	\$893.5	\$793.2	\$882.3	\$846.6	\$791.6
Cost of Products Sold	703.8	644.9	580.6	650.8	622.8	578.0
Gross Profit	234.3	248.6	212.6	231.5	223.8	213.6
SG&A Expenses	149.4	146.2	129.0	139.1	125.9	114.4
Operating Income	84.9	102.4	83.6	92.4	97.9	99.2
Interest Expense	41.0	42.9	22.9	22.9	25.9	30.9
Other Expense (Income)	(1.7)	0.1	1.1	1.1	0.5	(2.4)
Total	39.3	43.0	24.0	24.0	26.4	28.5
Income Before Taxes	45.6	59.4	59.6	68.4	71.5	70.7
Income Taxes	16.9	22.8	22.3	25.7	27.1	25.0
Net Income	\$28.7	\$36.6	\$37.3	\$42.7	\$44.4	\$45.7
				(4)%	(3)%	
Diluted Shares	205.4	203.5	202.2	202.2	212.1	210.6
Earnings Per Share	\$0.14	\$0.18	\$0.18	\$0.21	\$0.21	\$0.21
				-	-	
Gross Margin	25.0%	27.8%	26.8%	26.2%	26.4%	27.0%
SG&A/Sales	15.9	16.4	16.3	15.7	14.8	14.5
Operating Margin	9.1	11.5	10.5	10.5	11.6	12.5
Effective Tax Rate	37.1%	38.4%	37.4%	37.6%	37.9%	35.4%

(Continued)

**Table 1: Continued (a)**

	F2008	F2007 (d)	F2006 Cont. Ops. (c)	F2006	F2005	F2004
<b>January</b>						
Net Sales	\$1,001.1	\$907.2	\$789.6	\$878.5	\$861.3	\$811.1
Cost of Products Sold	747.9	649.1	571.3	638.3	629.1	582.6
Gross Profit	253.2	258.1	218.3	240.2	232.2	228.5
SG&A Expenses	138.4	135.4	125.8	136.2	124.5	106.2
Operating Income	114.8	122.7	92.5	104.0	107.7	122.3
Interest Expense	38.8	42.2	22.7	22.7	25.9	31.4
Other Expense (Income)	(1.1)	(0.6)	(0.1)	(0.1)	0.1	(0.5)
Total	37.7	41.6	22.6	22.6	26.0	30.9
Income Before Taxes	77.1	81.1	69.9	81.4	81.7	91.4
Income Taxes	26.7	28.0	24.7	29.4	31.1	34.6
Net Income	\$50.4	\$53.1	\$45.2	\$52.0	\$50.6	\$56.8
Diluted Shares	201.4	204.4	201.9	201.9	212.7	211.5
Earnings Per Share	\$0.25	\$0.26	\$0.22	\$0.26	\$0.24	\$0.27
Gross Margin	25.3%	28.5%	27.6%	27.3%	27.0%	28.2%
SG&A/Sales	13.8	15.0	15.9	15.5	14.5	13.1
Operating Margin	11.5	13.5	11.7	11.8	12.5	15.1
Effective Tax Rate	34.6%	34.5%	35.3%	36.1%	38.0%	37.9%
<b>April</b>						
Net Sales	\$1,044.1	\$940.1	\$799.2	\$847.1	\$847.1	\$915.9
Cost of Products Sold	789.4	697.1	595.3	646.1	646.1	663.1
Gross Profit	254.7	243.0	203.9	200.9	200.9	252.8
SG&A Expenses	144.2	142.4	117.0	102.3	102.3	109.8
Operating Income	110.5	100.6	86.9	98.6	98.6	143.0
Interest Expense	32.5	39.0	21.4	21.0	21.0	36.7
Other Expense (Income)	(0.3)	0.6	0.1	0.2	0.2	0.4
Total	32.2	39.6	21.5	21.2	21.2	37.1
Income Before Taxes	78.3	61.0	65.4	77.4	77.4	105.9
Income Taxes	24.5	15.9	23.7	28.0	28.0	37.8
Net Income	\$53.8	\$45.1	\$41.7	\$49.4	\$49.4	\$68.1
Diluted Shares	199.3	205.0	202.9	212.9	212.9	212.0
Earnings Per Share	\$0.27	\$0.22	\$0.21	\$0.23	\$0.23	\$0.32
Gross Margin	24.4%	25.8%	25.5%	23.7%	23.7%	27.6%
SG&A/Sales	13.8	15.1	14.6	12.1	12.1	12.0
Operating Margin	10.6	10.7	10.9	11.6	11.6	15.6
Effective Tax Rate	31.3%	26.1%	36.2%	36.2%	36.2%	35.7%

(a) Excludes nonrecurring gains and charges.

(b) 14 weeks. (c) Continuing operations. Reflects sale of soup and infant feeding businesses.

(d) Includes acquisitions of Meow Mix from May 19 and Milk-Bone from July 2, 2006. July quarter excludes \$10 million pretax gain on divestiture.



**Table 2: Continued (a)**

	F2008	F2007 (d)	F2006 Cont. Ops. (c)	F2006	F2005	F2004
<b>January</b>						
Net Sales:						
Consumer Products	\$624.8	\$551.0	\$562.3	\$651.2	\$638.3	\$608.8
Pet Products	376.3	356.2	227.3	227.3	223.0	202.3
Total	\$1,001.1	\$907.2	\$789.6	\$878.5	\$861.3	\$811.1
	+10%	+15%		+2%	+2%	+6%
Operating Income:						
Consumer Products	\$55.8	\$54.3	\$59.6	\$70.2	\$74.2	\$83.6
Pet Products	69.9	82.3	45.4	46.3	41.1	45.2
Total	125.7	136.6	105.0	116.5	115.3	128.8
Corporate	(10.9)	(13.9)	(12.5)	(12.5)	(7.6)	(6.5)
Total Income	\$114.8	\$122.7	\$92.5	\$104.0	\$107.7	\$122.3
	(6)%	+33%		(3)%	(5)%	(12)%
Operating Margin:						
Consumer Products	8.9%	9.9%	10.6%	10.8%	11.6%	13.7%
Pet Products	18.6	23.1	20.0	20.4	18.4	22.3
Total	12.6	15.1	13.3	13.3	13.4	15.9
Corporate	(1.1)	(1.5)	(1.6)	(1.5)	(0.9)	(0.8)
Total Income	11.5%	13.5%	11.7%	11.8%	12.5%	15.1%
<b>April</b>						
Net Sales:						
Consumer Products	\$642.4	\$594.9	\$573.4	225.8	\$626.6	(b) \$683.4
Pet Products	401.7	345.2	225.8		220.4	232.5
Total	\$1,044.1	\$940.1	\$799.2		\$847.0	\$915.9
	+11%	+18%		+2		(8)%
Operating Income:						
Consumer Products	\$51.3	\$42.3	\$59.1	41.1	\$62.1	\$92.4
Pet Products	76.8	72.1	41.1		48.9	59.1
Total	128.1	114.4	100.2		111.0	151.5
Corporate	(17.6)	(13.8)	(13.3)		(12.4)	(8.5)
Total Income	\$110.5	\$100.6	\$86.9		\$98.6	\$143.0
	+10%	+16%				(31)%
Operating Margin:						
Consumer Products	8.0%	7.1%	10.3%	18.2	9.9%	13.5%
Pet Products	19.1	20.9	18.2		22.2	25.4
Total	12.3	12.2	12.5		13.1	16.5
Corporate	(1.7)	(1.5)	(1.6)		(1.5)	(0.9)
Total Income	10.6%	10.7%	10.9%		11.6%	15.6%

(a) Pro forma for Heinz acquisition. Excludes nonrecurring items. (b) 14 weeks.  
(c) Continuing operations. Reflects sale of soup and infant feeding businesses.  
(d) Includes acquisitions of Meow Mix from May 19 and Milk-Bone from July 2, 2006. July quarter excludes \$10 million pretax gain on divestiture.

**Table 3: Del Monte Foods Company - Quarterly Operating Profit Margins**

	F2008	F2007	F2006 Cont. Ops. (a)	F2006	F2005	F2004 Cont. Ops.	F2004	F2003	F2002	F2001
<b>July</b>										
Consumer Products	3.2%	(b) 3.8%	7.1%	7.3%	8.8%	8.3%	8.3%	12.6%	15.2%	-
Pet Products	15.5	17.2	11.7	12.1	9.7	16.8	16.0	18.0	16.5	-
Total	8.2	8.8	8.6	8.7	9.1	10.6	10.5	14.1	15.6	17.0%
Corporate	(1.6)	(1.8)	(1.8)	(1.6)	(1.3)	(1.0)	(0.9)	(0.8)	(0.7)	(0.7)
Total	6.6%	7.0%	6.8%	7.1%	7.8%	9.6%	9.6%	13.3%	14.9%	16.3%
<b>October</b>										
Consumer Products	7.7%	9.3%	10.9%	10.6%	12.2%	12.0%	11.9%	10.3%	9.5%	-
Pet Products	14.1	19.4	15.6	15.9	15.2	19.0	16.4	20.2	19.0	-
Total	10.1	13.0	12.1	11.9	13.0	13.7	13.1	13.1	12.4	15.9%
Corporate	(1.0)	(1.5)	(1.6)	(1.4)	(1.4)	(1.2)	(0.9)	(0.9)	(1.1)	(0.6)
Total	9.1%	11.5%	10.5%	10.5%	11.6%	12.5%	12.2%	12.2%	11.3%	15.3%
<b>January</b>										
Consumer Products	8.9%	9.9%	10.6%	10.8%	11.6%	13.7%	13.7%	12.7%	12.6%	-
Pet Products	18.6	23.1	20.0	20.4	18.4	22.3	21.1	21.1	17.4	-
Total	12.6	15.1	13.3	13.3	13.4	15.9	14.9	14.9	13.9	15.0%
Corporate	(1.1)	(1.5)	(1.6)	(1.5)	(0.9)	(0.8)	(0.4)	(0.4)	(0.9)	(0.6)
Total	11.5%	13.5%	11.7%	11.8%	12.5%	15.1%	14.5%	14.5%	13.0%	14.4%
<b>April</b>										
Consumer Products	8.0%	7.1%	10.3%		9.9%	13.5%		10.8%	9.2%	
Pet Products	19.1	20.9	18.2		22.2	25.4		19.5	19.8	
Total	12.3	12.2	12.5		13.1	16.5		13.1	12.4	
Corporate	(1.7)	(1.5)	(1.6)		(1.5)	(0.9)		(0.2)	(0.8)	
Total	10.6%	10.7%	10.9%		11.6%	15.6%		12.9%	11.6%	

(a) Reflects divestiture of soup and infant feeding businesses. (b) Includes acquisitions of Meow Mix on May 19 and Milk-Bone on July 2. July quarter excludes \$10 million pretax gain on divestiture.



## 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 Del Monte Foods reports issued by me are: 3/4/05 (\$11) – Strong Buy – Target \$13-\$14; 7/20/05 (\$11.20) – Strong Buy – Target \$13-\$14; 9/29/05 (\$10.70) – Strong Buy – Target \$13-\$14; 12/7/05 (\$10.20) – Strong Buy – Target \$13-\$14; 1/12/06 (\$10.4) – Strong Buy – Target \$13-\$14; 3/30/06 (\$11.90) – Strong Buy – Target \$14-\$15; 6/15/06 (\$11.30) – Strong Buy – Target \$14-\$15; 7/26/06 (\$10.50) – Strong Buy – Target \$14-\$15; 9/15/06 (\$10.20) – Strong Buy – Target \$14-\$15, 12/7/06 (\$11.25) – Strong Buy – Target \$14-\$15; 3/19/07 (\$11.15) – Strong Buy – Target \$14-\$15; 6/27/07 (\$12) – Strong Buy – Target \$15-\$16; 9/5/07 (\$10.60) – Strong Buy – Target \$14-\$15; 12/19/07 (\$8.80) – Strong Buy – Target \$12-\$13; 3/4/08 (\$9.15) – Strong Buy – Target \$12-\$13.

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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*	71%	0%
Hold	29%	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.

## Important Disclosures, continued



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