



140 BROADWAY NEW YORK, NY 10005

ROBERT J. CUMMINS, CFA  
(212) 651-0815

TRADING DESK  
(212) 320-3001

SEPTEMBER 5, 2007

## COMPANY SUMMARY

### Wednesday, September 5, 2007

Speaker: Bob Cummins

Rating: Strong Buy

Food Industry Comment:

#### Del Monte Foods (DLM-\$10.60)

	<u>F2007</u>	<u>F2008E</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	\$0.78	\$0.90	\$0.16	205.7	\$13-\$10	\$14-\$15
P/E	-	13.6x	11.8x	1.5%			

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

Del Monte continues to experience inflationary cost pressures, particularly for tunafish, and despite price increases and cost reduction efforts, management has reduced its EPS guidance for the April 2008 fiscal year from \$0.78-\$0.82, before one-time items, indicating growth of 8%-14%, to the low end of that range. While that is obviously disappointing, it is more than reflected in the price of the stock, and we continue to believe in DLM's ability to generate substantially higher profits as commodity costs ease and as the Pet Products segment, now 62% of operating income, continues to gain in importance. We believe that purchases at the current price will prove highly rewarding over time, and are reemphasizing our "1" (Strong Buy) rating, although we are reducing our 12-month target price from the \$15-\$16 range established in June to the previous \$14-\$15 to reflect the less favorable near-term outlook and recent price declines for food stocks in general.

The company last week reported results for its seasonally low first quarter ending in July, which typically accounts for less than 10% of full-year EPS and thus has little affect on annual results. Sales for the period increased 12%, which reflects a 2.2% impact from price increases and the inclusion of the company's most recent acquisitions, Meow Mix and Milk-Bone, in last year's quarter for only 11 and 5 weeks, respectively. Operating income before one-time items

(Continued)

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

(Continued)

increased only 6%, as the margin declined 40 basis point to 6.6% of sales, also a seasonal low. Interest and other expense increased 43%, mainly reflecting the acquisitions, thus it is not surprising that EPS declined to just \$0.03, versus \$0.06 last year.

Consumer Foods, the larger of the company's two business segments, reported healthy sales growth of 6%, reflecting higher prices and some successful new fruit products under the Del Monte brand. However, profits declined 10%, following a substantial decline a year ago, and the operating margin shrank to 3.2%, versus 3.8% last year, and 7.1% in F1Q-06. For the past several years, the company has faced margin pressures from higher ingredient costs, and has responded by raising prices and increasing efficiency. Higher marketing outlays to support new products were also a factor in the F1Q earnings decline. While the company does not break out results by product lines, management stated on the recent conference call that the Del Monte Brands businesses are performing well, and are expected to show good results in the coming quarters. The principal challenge both in F2007 and F2008 has been StarKist. The cost of skipjack tuna (70% of volume) has risen dramatically to a record high due to a reduced catch, while albacore products (30%) are experiencing intensive competition. The company has instituted price increases, but is now encountering consumer resistance. Supplies and prices seem likely to return to more normal levels eventually, but there appears to be no sign of it as yet.

The Pet Products segment, on the other hand, which accounts for 38% of sales, but nearly two-thirds of profits, is a more stable, brand-oriented business, where demand is growing more rapidly, ingredient costs are a much smaller percentage of sales, and more readily passed along, and competition is based on product innovation and marketing. The 57% increase in DLM's pet sales through last year's acquisitions, to \$1.3 billion annually, made the company a major presence in this industry, and we expect it to add both increased stability and higher growth potential going forward. Sales growth of 22% in F1Q was mainly attributable to the acquisitions, although management states that sales of both of the new brands are above a year ago, and their integration with the existing operations is expected to contribute \$6 million of synergies (\$0.02 per share after taxes) in F2008. The base business also achieved growth in the quarter.

The pet food industry is also subject to rising ingredient prices, in this case largely for grains, fats and oils, but the company raised prices during the July quarter to cover the added expense. We note that pet profits rose just 10% in F1Q, well below the sales increase, and although the operating margin was a healthy 15.5% of sales, nearly five times that of the consumer business, it was below the 17.2% of a year ago, which included the new brands for less than a full quarter. This year's reduced margin reflects both higher input costs and increased marketing expenditures. Both figures are significantly higher than the 10%-12% margins earned by DLM's preexisting pet food businesses in F1Q-06 and F1Q-05. As in Consumer Products, we expect the margin to widen seasonally over the balance of the year.

(Continued)

(Continued)

In the October quarter, Consumer Products is expected to show continued healthy sales growth, while operating income is likely to be flat, reflecting higher fish costs. In Pet Products, sales are also expected to grow, but profits will be down, as a result of a full quarter's impact from recent cost increases, partly offset by higher prices. On an overall basis, management projects F2Q sales growth for Del Monte at 7%-9%, but expects the operating margin to narrow from last year's 11.5% of sales to 8.8%-9.8%. EPS for the period, excluding one-time items, are estimated at \$0.15-\$0.19, versus \$0.18 in each of the past two years. That would put six-month EPS at \$0.18-\$0.22, down from \$0.24 a year ago.

On the other hand, the company is clearly optimistic about earnings prospects for the second half, based on rising sales, the full impact of recent price increases, and ongoing cost reduction programs. DLM's revised F2008 EPS forecast of \$0.78 from operations implies F2H earnings of \$0.56-\$0.60, or 17%-25% above last year's \$0.48. In view of the present depressed stock price and modest valuation, such an acceleration of earnings momentum could attract considerable interest.

While we view the Pet Products segment as the more dynamic of Del Monte's two business units, Consumer Products has the potential for significant earnings recovery assuming a more stable commodity price environment. It is by far the larger of the two segments, with annual sales of \$2.2 billion, and its operating margin has declined from 9.9% in F2006 to only 7.6% in the latest 12 months. A recovery to the F2006 margin would generate an additional \$50 million of pretax income, or \$0.16 per share after taxes, representing a 23%-24% increase on estimated EPS of \$0.66-\$0.70 for the 12 months ending in October, 2007.

Del Monte's price/earnings ratio of 14.7 times estimated calendar 2007 EPS of \$0.72 is far below the 18.5 average for the other 12 brand-name food companies we follow, which range between 16.2 and 21.3 times. The discount clearly reflects the company's disappointing earnings record. It may also be a function of its relatively high debt level, with total debt net of cash amounting to just under \$2 billion at the end of the April fiscal year, in large part reflecting last year's pet food acquisitions. That compares with an equity market capitalization of \$2.2 billion at the present price. On the other hand, net income and noncash charges, net of capital expenditures and dividends, based on our calculations amounted to \$193 billion in F2007, an amount that should rise as earnings increase. We expect that free cash flow will be used primarily to reduce debt.

**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
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
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	\$893.5	\$893.5	\$793.2	\$882.3	\$846.6	\$791.6
Cost of Products Sold	644.9	644.9	580.6	650.8	622.8	578.0
Gross Profit	248.6	248.6	212.6	231.5	223.8	213.6
SG&A Expenses	146.2	146.2	129.0	139.1	125.9	114.4
Operating Income	102.4	102.4	83.6	92.4	97.9	99.2
Interest Expense	42.9	42.9	22.9	22.9	25.9	30.9
Other Expense (Income)	0.1	0.1	1.1	1.1	0.5	(2.4)
Total	43.0	43.0	24.0	24.0	26.4	28.5
Income Before Taxes	59.4	59.4	59.6	68.4	71.5	70.7
Income Taxes	22.8	22.8	22.3	25.7	27.1	25.0
Net Income	\$36.6	\$36.6	\$37.3	\$42.7	\$44.4	\$45.7
Diluted Shares	203.5	203.5	202.2	202.2	212.1	210.6
Earnings Per Share	\$0.18	\$0.18	\$0.18	\$0.21	\$0.21	\$0.21
Gross Margin	27.8%	27.8%	26.8%	26.2%	26.4%	27.0%
SG&A/Sales	16.4	16.4	16.3	15.7	14.8	14.5
Operating Margin	11.5	11.5	10.5	10.5	11.6	12.5
Effective Tax Rate	38.4%	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		\$907.2	+15%	\$789.6	\$878.5	\$861.3
Cost of Products Sold		649.1		571.3	638.3	629.1
Gross Profit		258.1	+18	218.3	240.2	232.2
SG&A Expenses		135.4	+33	125.8	136.2	124.5
Operating Income		122.7		92.5	104.0	106.2
Interest Expense		42.2		22.7	22.7	31.4
Other Expense (Income)		(0.6)		(0.1)	0.1	(0.5)
Total		41.6		22.6	26.0	30.9
Income Before Taxes		81.1	+16	69.9	81.7	91.4
Income Taxes		28.0		24.7	31.1	34.6
Net Income		\$53.1	+17%	\$45.2	\$50.6	\$56.8
Diluted Shares		204.4	+1%	201.9	212.7	211.5
Earnings Per Share		\$0.26	+18	\$0.22	\$0.24	\$0.27
Gross Margin		28.5%		27.6%	27.0%	28.2%
SG&A/Sales		15.0		15.9	14.5	13.1
Operating Margin		13.5		11.7	12.5	15.1
Effective Tax Rate		34.5%		35.3%	38.0%	37.9%
<b>April</b>						
Net Sales		\$940.1	+18%	\$799.2	\$847.1	\$915.9
Cost of Products Sold		697.1		595.3	646.1	663.1
Gross Profit		243.0	+19	203.9	200.9	252.8
SG&A Expenses		142.4	+16	117.0	102.3	109.8
Operating Income		100.6		86.9	98.6	143.0
Interest Expense		39.0		21.4	21.0	36.7
Other Expense (Income)		0.6		0.1	0.2	0.4
Total		39.6		21.5	21.2	37.1
Income Before Taxes		61.0	(7)	65.4	77.4	105.9
Income Taxes		15.9		23.7	28.0	37.8
Net Income		\$45.1	+8%	\$41.7	\$49.4	\$68.1
Diluted Shares		205.0	+1%	202.9	212.9	212.0
Earnings Per Share		\$0.22	+5	\$0.21	\$0.23	\$0.32
Gross Margin		25.8%		25.5%	23.7%	27.6%
SG&A/Sales		15.1		14.6	12.1	12.0
Operating Margin		10.7		10.9	11.6	15.6
Effective Tax Rate		26.1%		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	F2005	F2004
<b>January</b>					
Net Sales:					
Consumer Products	\$551.0	(2)%	\$661.2	\$638.3	\$608.8
Pet Products	356.2	+57	227.3	223.0	202.3
Total	<u>\$907.2</u>	<u>+15%</u>	<u>\$878.5</u>	<u>\$861.3</u>	<u>\$811.1</u>
Operating Income:					
Consumer Products	\$54.3	(9)%	\$70.2	\$74.2	\$83.6
Pet Products	82.3	+81	46.3	41.1	45.2
Total	136.6	+30	116.5	115.3	128.8
Corporate	(13.9)	-	(12.5)	(7.6)	(6.5)
Total Income	<u>\$122.7</u>	<u>+33%</u>	<u>\$104.0</u>	<u>\$107.7</u>	<u>\$122.3</u>
Operating Margin:					
Consumer Products	9.9%	10.6%	10.8%	11.6%	13.7%
Pet Products	23.1	20.0	20.4	18.4	22.3
Total	15.1	13.3	13.3	13.4	15.9
Corporate	(1.5)	(1.6)	(1.5)	(0.9)	(0.8)
Total Income	<u>13.5%</u>	<u>11.7%</u>	<u>11.8%</u>	<u>12.5%</u>	<u>15.1%</u>
<b>April</b>					
Net Sales:					
Consumer Products	\$594.9	+4%	\$626.6	(b)	\$683.4
Pet Products	345.2	+53	225.8	220.4	232.5
Total	<u>\$940.1</u>	<u>+18%</u>	<u>\$847.0</u>	<u>(8)%</u>	<u>\$915.9</u>
Operating Income:					
Consumer Products	\$42.3	(28)%	\$62.1	\$62.1	\$92.4
Pet Products	72.1	+75	41.1	48.9	59.1
Total	114.4	+14	111.0	111.0	151.5
Corporate	(13.8)	-	(12.4)	(12.4)	(8.5)
Total Income	<u>\$100.6</u>	<u>+16%</u>	<u>\$98.6</u>	<u>(31)%</u>	<u>\$143.0</u>
Operating Margin:					
Consumer Products	7.1%	10.3%	10.8%	9.9%	13.5%
Pet Products	20.9	18.2	18.2	22.2	25.4
Total	12.2	12.5	13.1	13.1	16.5
Corporate	(1.5)	(1.6)	(1.5)	(1.5)	(0.9)
Total Income	<u>10.7%</u>	<u>10.9%</u>	<u>11.6%</u>	<u>11.6%</u>	<u>15.6%</u>

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

**Table 4: Del Monte Foods Company - Annual Income Statements (a)**

	F2007 (b)		F2006		F2005 (c)		F2005		F2004 (d)	
Net Sales	\$3,414.9	+14%	\$2,998.6	+3%	\$2,899.3	\$3,180.9	+2%	\$3,129.9		
Cost of Products Sold	2,500.8		2,213.9		2,155.5	2,378.6		2,281.3		
Gross Profit	914.1	+16	784.7	+5	743.8	802.3	(5)	848.6		
SG&A Expenses	539.8		479.9		419.5	448.4		425.6		
Operating Income	374.3	+23	304.8	(6)	324.3	353.9	(16)	423.0		
Interest Expense	154.6		88.2		97.4	97.4		129.0		
Other Expense (Income)	0.4		1.1		2.8	2.8		(1.7)		
Total	155.0		89.3		100.2	100.2		127.3		
Income Before Taxes	219.3	+2	215.5	(4)	224.1	253.7	(14)	295.7		
Income Taxes	71.5		78.5		83.8	94.4		107.9		
Net Income	\$147.8	+8%	\$137.0	(3)%	\$140.3	\$159.3	(15)%	\$187.8		
Diluted Shares	203.8	-	204.2	(4)%	212.4	212.4	+1%	211.2		
Earnings Per Share	\$0.72	+7%	\$0.67	+2	\$0.66	\$0.75	(16)	\$0.89		
% of Sales:										
Gross Profit	26.8%		26.2%		25.7%	25.2%		27.1%		
SG&A Expense	15.8		16.0		14.5	14.1		13.6		
Operating Income	11.0		10.2		11.2	11.1		13.5		
Effective Tax Rate	32.6%		36.4%		37.4%	37.2%		36.5%		

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

(b) Includes acquisitions of Meow Mix on May 19 and Milk-Bone on July 2. Excludes \$10 million pretax gain on divestiture.

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

(d) 53 weeks. EPS based on 52 weeks estimated at \$0.87.

## 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.

## Important Disclosures

### 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.

### Analyst's Ratings Distribution

		% Investment Banking
Buy*	71%	0%
Hold	29%	0%
Sell	0%	0%

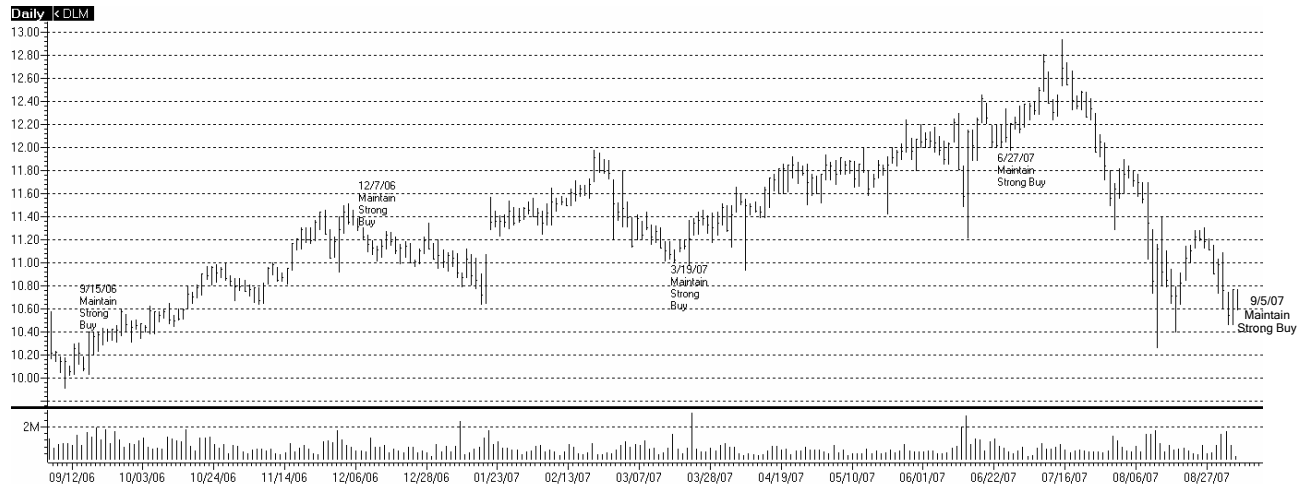
\*Includes companies rated "Strong Buy" and "Buy."

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



The analyst and his household members hold positions in the common shares of the subject company in various accounts.

Capital Management Associates holds positions in the common shares of the subject company in managed accounts.

Neither Shields nor a director, officer or the research analyst has received any compensation for products or services from the subject company in the past 12 months.

## Other Disclosures and Disclaimers

This research report and recommendations agree with the personal opinion of the analyst who prepared this report.

Any financial interest that the research analyst or member of the analyst's household or any other individual directly involved with the preparation of this report has in the subject company, has been disclosed in the Important Disclosures section.

Investing is a risky activity and can lead to substantial losses. This report does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. Shields & Company recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives.

## **Other Disclosures and Disclaimers, continued**

This report is not an offer to buy or sell any security or to participate in any trading strategy. Shields & Company and/or its employees not involved in the preparation of this report may have investments in securities or derivatives of securities of companies mentioned in this report, and may trade them in ways different from those discussed in this report. Derivatives may be issued by Shields & Company or associated persons. The firm does not make a market in the shares of the companies mentioned, has no relationship with them, and has not received any compensation from them.

Shields & Company makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in this report change apart from when we intend to discontinue research coverage of a subject company.

Reports prepared by Shields & Company and its research personnel are based on public information. Facts and views presented in this report have not been reviewed by, and may not reflect information known to, professionals in other business areas.

Shields & Company research personnel conduct site visits from time to time but are prohibited from accepting payment or reimbursement by the company of travel expenses from such visits.