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SEPTEMBER 14, 2004

COMPANY SUMMARY

Tuesday, September 14, 2004

Speaker: Bob Cummins

Food Industry Comment:

Del Monte Foods: (DLM-$10.90)- We met with the management of DLM last week, and were pleased to learn that this year's steep increases in the cost of raw materials, packaging and energy are being fully offset through price increases and cost reduction steps, as well as declines in some commodities from their recent highs. That adds to our confidence that DLM can achieve its goals of F2Q (October) EPS close to last year's $0.21 (versus a 33% decline in the seasonally slow F1Q), and a resumption of growth in the second half. The shares have gained strength recently, reflecting the improving outlook as well as the announcement that DLM's former controlling stockholder is selling all of its remaining holdings in an underwritten offering. Nevertheless, the P/E ratio is still a modest 12 times. We believe the shares are poised to move higher as the prospects for the balance of F2005 come into clearer focus, and are reemphasizing our "1" (Strong Buy) rating, as well as our 12-month target price of $14-$15.

The purchase of several major businesses from Heinz in December, 2002, transformed Del Monte from a successful but relatively small branded food company, with annual sales of $1.4 billion, single-digit profit margins, and a largely mature product line, to a $3.1 billion diversified packaged-foods marketer, with healthy double-digit margins, and one-third of its sales derived from segments that management views as having above-average growth potential. Besides its established Del Monte, S&W and Contadina brands, DLM now owns such prominent lines as StarKist, Nature's Goodness, College Inn, 9Lives, Kibbles 'n Bits, Snausages, Pep-Peroni, NawSomes, Pounce, Meaty Bone, and Scooby Snacks, and also has become the principal supplier of private label soups to grocery retailers. It holds the number one or two market share in eleven grocery categories, compared with four previously. Based on data from A.C. Nielsen, DLM now ranks 11th in annual U.S. grocery center store branded food sales (frozen and dry grocery combined), ahead of Heinz itself, which is 12th.

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In addition, since the deal was financed largely through the issuance of DLM stock to Heinz shareholders, the company was able to maintain a strong balance sheet, while trading activity in its shares increased significantly, as its equity market value rose from only $500 million to the present $2.3 billion.

Since the closing, management has successfully integrated the DLM and HNZ businesses, while developing and implementing strategies to take maximum advantage of sales and earnings opportunities in the acquired businesses. Advertising and marketing budgets have been increased, as has new product activity, with an emphasis on the product areas that management has identified as having the best growth potential and the highest profit margins, namely the tuna pouch products, pet snacks, dry dog and cat food, premium fruits, cut tomato products, and broth. Thus far in F2005, the company has achieved particularly strong growth for the StarKist pouch line, as well as for pet foods and snacks, partly reflecting successful new product introductions. The private label soup business is also showing good growth, as a result of expanded distribution, added shelf space, additional varieties of ready-to-serve soups, and the introduction of microwaveable soups.

The inflationary trend in costs caused DLM's gross margin to narrow by 180 basis points, to 23.5% of sales, in the July quarter, and that was a principal reason for the earnings decline. Despite progress in passing along costs, we suspect that the F2Q margin could also be down slightly, against a relatively difficult comparison. However, management remains confident that the gross margin for F2005 as a whole will be equal to last year's, implying strong year-to-year gains in both margins and dollar profits in the second half. The company's earnings guidance for the year, before integration expense, is $0.87-$0.92 per share, compared with $0.89 on the same basis in F2004, which included an extra week in F4Q.

De Monte's net borrowings declined by $264 million, to $1.34 billion, in F2004, reflecting the use of free cash flow and the proceeds of a divestiture for this purpose. The company expects to generate in excess of $200 million of excess cash in F2005, and debt reduction will continue to be the principal use of the funds. Interest expense in the July quarter was 18% below a year ago, a saving that contributed nearly $0.02 to EPS. We expect this deleveraging process to continue benefiting earnings comparisons over the balance of the year. We have not yet established a firm EPS estimate for F2006, but we would be surprised if rising sales, expanding profit margins and declining interest expense did not lead to a healthy increase. We also expect that the board will give serious consideration to establishing DLM's first quarterly dividend at the end of F2005.

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The company recently announced changes in its top management that reflect Del Monte's expanded size and scope. In July, Wesley Smith, Chief Operating Officer since 1997, retired. Significantly, Todd Lachman, age 41, a highly regarded executive who ran Heinz's pet food business, and joined DLM at the time of the acquisition, was named Executive Vice President of the corporation, with responsibility for all three of its business units, Del Monte Brands, StarKist Brands, and Pet Products, making him, in effect, second in command to Rick Wolford, Chairman, President and CEO. Nils Lommerin, age 39, who joined DLM in 2003 as Executive Vice President, Human Resources, was named Executive Vice President, Operations, with responsibility for all of the company's manufacturing and supply chain functions. Don Binotto, age 49, another ex-Heinz executive who had been Managing Director, StarKist Brands, was named Senior Vice President, Operations and Supply Chain, reporting to Mr. Lommerin.

Separately, last week the company announced the appointment of Tim Cole as Executive Vice President, Sales. Prior to joining DLM, Mr. Cole had spent 25 years in sales and marketing at Quaker Oats, now a division of PepsiCo, and most recently was its Vice President of National Accounts. It is interesting to note that five of Del Monte's ten top executive officers, including Melissa Plaisance, Senior Vice President, Finance and Corporate Communications, have joined the company since the Heinz deal, with two of those coming directly from Heinz.

Prior to the Heinz transaction, nearly half of Del Monte's shares were owned by a unit of Texas Pacific Group. That was reduced to 12% as a result of the new shares issued to Heinz shareholders in December, 2002, but TPG retained a seat on the board. In January, 2004, it sold 12 million shares, or about half of its holdings, in a registered secondary offering, and subsequently relinquished its board seat. On September 10, 2004, DLM announced that TPG was selling its remaining 12.3 million shares in a similar offering, with the closing expected to occur on or about September 15th. While TPG no longer had any involvement in the management of DLM, the overhang of this block had been a concern to some investors. Del Monte was already an actively traded stock, averaging nearly 600,000 shares per day in August, but the sale of TPG's holding should add to its liquidity.

Del Monte has scheduled an all-day session for investors on October 14th in Pittsburgh, with presentations by the top corporate officers, as well as leaders of the individual business units, and a plant tour.

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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.
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.
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