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## COMPANY SUMMARY

Friday, September 15, 2006

Speaker: Bob Cummins

Rating: Strong Buy

### Food Industry Comment:

**Del Monte Foods** (DLM-\$10.20) – At a Shields-sponsored luncheon meeting in New York last week, CEO Rick Wolford discussed the company's brand portfolio, its strategies to increase sales and expand profit margins, and its goals for future performance. We continue to view DLM as one of the most attractive investment ideas in the food industry, particularly since the shares have retreated to the low end of their three-year trading range, down from a high of \$12.17 in May. We look for a gradual recovery in profit margins and a strengthening of its earnings trends over the next 12 months, based on healthy volume growth, price increases, a favorable product mix, synergies from the recent acquisitions, and an alleviation of the inflationary pressures that have squeezed profit margins over the past two years. We estimate recovery earning power to be in excess of \$1.00 per share, compared with management's guidance of about \$0.75 from operations for the April 2007 fiscal year. Signs of progress in that direction in our view could lead to healthy appreciation from this depressed level. Rated "1" (Strong Buy), 12-month target price \$14-\$15.

Since the December, 2002 transaction with Heinz, which nearly doubled Del Monte's annual sales and significantly broadened its product lines, the company has been strengthened in many ways:

- The management team has been enhanced through the recruiting of a number of experienced executives from outside the company to fill key positions. These include Timothy Cole (ex Quaker Oats and PepsiCo), Executive VP, Sales; Nils Lommerin (ex Kraft, PepsiCo, and Oxford Health Plans), Executive VP, Operations; and Jeffrey Watters (ex Kraft, Clorox and Heinz), Senior VP, Pet Products.

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- The company's already well-entrenched brands have been strengthened further through more effective marketing.
- New value-added, higher-margin items have been successfully introduced in virtually every product area, thereby enhancing sales growth, market share, and profit potential.
- The company has made significant progress in reducing expenses and increasing operating efficiency.
- Prices have been increased across the board where necessary to offset rising costs.
- DLM's ample free cash flow has been used to reduce debt and to repurchase 5% of its outstanding stock.
- Last but not least, the divestiture of the company's soup and infant feeding businesses (\$295 million annual sales) in April, and the purchase of two well-established pet products brands, Meow Mix and Milk-Bone (\$430 million sales) in May and July, respectively, has eliminated two low profit margin, non-branded lines with limited potential, while expanding its growing and highly profitable pet food business by 50%. Pet products will now account for 40% of sales and an estimated 52% of operating profits, up from 25% and 36% in the past. As the new businesses are integrated, management expects to achieve \$20 million of annual cost savings. In addition, it sees significant growth potential for Milk-Bone, a well-known brand that has been neglected.

Management's accomplishments have been overshadowed in the past two years by the impact of inflation, as rising costs for energy, packaging, transportation and other inputs have outpaced the benefits of higher volume, efficiency gains and price increases. As a result, DLM's operating margin excluding one-time items narrowed from 13.5% of sales in F2004 to 11.2% in F2005 and 10.2% in F2006. Adjusted EPS declined from \$0.89 in F2004 to \$0.77 (\$0.67 from continuing operations) in F2006.

In F2007, the company has experienced atypical double-digit price increases for peaches and tomatoes due to unfavorable weather conditions. Tunafish costs are also above normal. On the other hand, management is cautiously optimistic that inflation for most non-agricultural commodities will now moderate. The cost of tinplate, used in DLM's fruit, vegetable, tuna and pet food businesses, rose at double-digit rates in each of the past two years, but this year is up only 2%-3%. The dramatic rise in energy costs appears to be past, and the present price of oil is fully reflected in the company's pricing and cost structure. Trucking costs are stabilizing. Meanwhile, the company over recent months has continued to post price increases where appropriate, and after a normal six-month lag the impact on profit margins should begin to be

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apparent by the second half of F2007, as should the planned synergies from the pet products integration.

Based on selective price increases for tomato products, seafood and other items, continued efficiency gains, the additional high-margin pet food sales, and reduced pressure from energy and other costs, we expect F2007 to mark the beginning of a recovery in DLM's profit margins. Management's stated goal for the long term is to achieve an overall operating margin of 12% of sales, compared with last year's 10.2%. That goal appears conservative, in view of the expectation that pet products in the future will account for more than half of segment profits. That area earned 16.6% on sales in F2006, and 14.4% in the seasonally low F1-07, compared with 9.9% and 7.1%, respectively, for consumer products. Over the long term, the company expects to achieve annual growth of 3%-5% in revenues (excluding further acquisitions), and 7%-9% in EPS.

It should be emphasized that despite disappointing earnings over the past several years, DLM is solidly entrenched as a top-tier consumer packaged foods company, and an industry leader in its major product categories. Pro forma for the recent transactions, we estimate annual sales at \$3.5 billion, including \$2.2 billion in consumer foods and \$1.3 billion in pet foods. The Del Monte brand holds the number one market share in processed fruits, vegetables and tomato products. StarKist is the industry leader in tuna, including the dominant position in the rapidly growing and highly profitable pouch segment. With the recent acquisitions in pet products, DLM is now the second largest company in that industry, versus number three previously. It is the industry leader in pet snacks and ranks second in dry cat food, up from second and fourth, respectively, while maintaining its number two position in canned cat food. In addition to the newly acquired lines, its well-known pet products brands include Kibbles 'n Bits, 9Lives, Pounce, Pup-Peroni, Snausages, Jerky Treats, Canine Carry-Outs and Meaty Bone. Management takes pride in the fact that the company has been successful in maintaining its market shares in both consumer and pet products over the past several years despite its aggressive pricing initiatives to cover rising costs.

## 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.

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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.

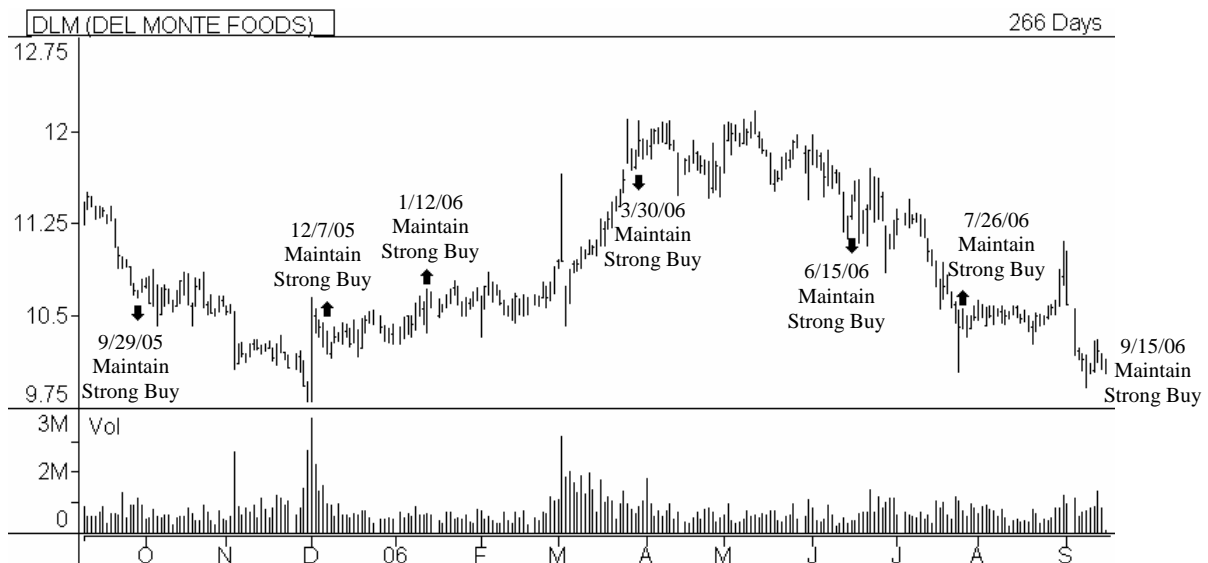
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Our target prices are based on projected earnings for the following calendar year, and an assumed price/earnings ratio in line with the company's historical valuation or those of other companies with similar businesses and prospects.

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.



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