



140 BROADWAY NEW YORK, NY 10005

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

TRADING DESK
(212) 320-3001

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COMPANY SUMMARY

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Speaker: Bob Cummins

Food Industry Comment:

Del Monte Foods (DLM-\$10.20) continues to manage its businesses well, but like most other food companies has been adversely affected by rising costs for packaging, energy, transportation and other inputs. Thus, sales for the six months ended October showed a healthy 5.5% increase, mostly reflecting higher prices, but operating income declined 3%. Thanks to the use of free cash flow to reduce debt and repurchase shares, EPS increased 7%, and exceeded management's guidance, but the company now believes EPS for the April 2006 fiscal year will be at the low end of the projected \$0.75-\$0.80 range, citing further cost pressures. Nevertheless, we continue to expect a gradual recovery in profit margins to historical levels through further pricing actions and efficiency gains, as well as an eventual easing of inflation. Based on the present annual sales of \$3.3 billion, we project recovery earning power at \$1.10 per share, and expect that the stock, which has traded between \$10 and \$11 for two years, will rise to new highs in response. We reemphasize our "1" (Strong Buy) rating, and our 12-month target price of \$13-\$14. We consider DLM one of our best buy ideas among the mid-cap food companies.

DLM last week reported F2Q results that on balance were encouraging, given the cost pressures facing the industry. Sales increased 4.2%, which was entirely attributable to price increases, as additional volume from new products was offset by reduced sales of existing lines in reaction to the pricing actions, as expected. Excluding one-time items, operating income declined 6%, as the margin narrowed to 10.5%, versus 11.6% in F2Q-05, and 12.5% in F2Q-04. However, interest expense was down 8%, as a result of debt repayment and refinancing, while shares outstanding declined 5%, reflecting DLM's accelerated stock buyback in June. Thus, EPS of \$0.21 were even with a year ago, and at the high end of management's \$0.16-\$0.21 guidance. Based on the operating margin of two years ago, EPS would have been \$0.27, 29% higher than those reported.

Consumer Products, the larger of DLM's two business segments (74% of annual sales, 63% of profits), reported strong sales growth of 7% for F2Q, including increases of nearly 9% for Del Monte Brands, and 14.5% for Private Label Soup, while StarKist Seafood was down nearly 1%, as the company deemphasized low-margin commodity products. Sales growth for the

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See pages 3 to 5 of report for Analyst's Certification and important disclosures.

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Consumer segment stemmed largely from price increases, which in turn led to reduced volume in some lines. However, Del Monte fruits and StarKist pouch tuna registered good growth, and new products, including StarKist Tuna Fillets and Del Monte Organic Tomatoes and Garden Select Tomatoes, also contributed. The large increase in soup sales reflected expanded distribution. Despite higher prices to offset cost pressures, the Consumer segment reported a 7% decline in operating income, partly reflecting increased SG&A expense. The operating margin narrowed to 10.6% of sales, compared with 12.2% a year ago and 12.0% in F2Q-04.

Pet Products (26% of sales, 37% of earnings), as expected, reported a 4% decline in sales for the quarter, against a strong prior-year increase of 14%, when the company restaged the 9Lives brand and introduced a wet Kibbles 'n Bits product. New products this year in the high-margin, high-growth dry dog food and pet snacks areas, which DLM is emphasizing, include Kibbles n' Bits Homestyle Beef and Meaty Bone Denta Delicious. A decline in marketing expenditures from last year's high level enabled the segment to report a modest increase in operating income despite lower sales. The 15.9% margin was up from 15.2% last year, but still well below the 19.0% earned two years ago.

As mentioned, lower interest expense was an important contributor to DLM's earnings performance for F2Q and the year to date. Ever since the Heinz transaction three years ago, management has put a strong emphasis on reducing its debt, which at that time amounted to just over \$1.6 billion, net of cash. Net debt at the end of October, 2005, although seasonally high at \$1.32 billion, was \$179 million lower than a year earlier, despite the repurchase of 12 million shares in June for \$125 million. For F2006 as a whole, DLM expects to generate cash flow of \$190-\$200 million, or \$0.94-\$0.99 per share.

Management's revised earnings guidance of \$0.75 per share for F2006 implies second-half EPS of \$0.46, which would compare with \$0.47 from operations last year. Sales are expected to rise 1%-3%, year over year. The company expects top-line growth in Consumer Products to moderate, reflecting reduced merchandising emphasis on some fruit items due to low inventories, as well as a more difficult comparison for soup. The company will continue to focus its resources on higher margin categories and on products and marketing strategies that emphasize health and wellness. Operating income will continue to be negatively affected by steel, energy, logistics, and other transportation-related costs. The Pet Products segment is expected to see a resumption of positive top-line growth, reflecting favorable trends in dry pet foods and snacks, but here also, higher costs are expected to continue.

Management had estimated this year's cost increases at \$120 million (equal to \$0.37 per share after taxes), but has now revised that figure to \$160 million (\$0.49). Given the magnitude of those inflationary pressures, it is clear that DLM to date has done an outstanding job of maintaining its profitability through price adjustments and increased efficiency. This adds to our confidence that strong earnings growth will resume as the pressures abate.

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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.

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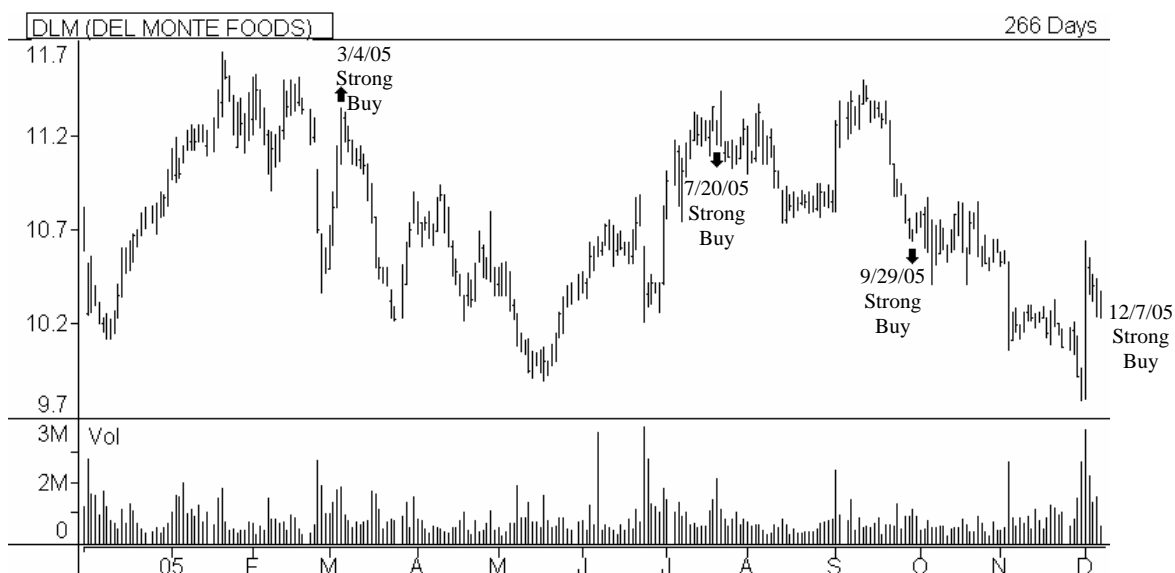
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