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COMPANY SUMMARY

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Speaker: Bob Cummins

Rating: Strong Buy

Food Industry Comment:

Del Monte Foods (DLM-\$11.25)

	<u>F2006</u>	<u>F2007E</u>	<u>F2008E</u>	<u>Dividend/ Yield</u>	<u>Shares Out. (mil.)</u>	<u>12-Mo. Range</u>	<u>12-Mo. Target</u>
EPS (a)	\$0.67(b)	\$0.75	\$0.90	\$0.16	201.2	\$12-\$10	\$14-\$15
P/E	-	15.0x	12.5x	1.4%			

(a) April fiscal years. Excludes one-time items.

(b) Continuing operations.

Del Monte Foods last week reported flat EPS of \$0.18, before one-time charges, for its second quarter ended October, a good performance considering inflationary cost increases for fruits, vegetables, seafood and packaging, as well as a near-doubling of interest expense related to the acquisition of the Meow Mix and Milk-Bone pet food lines last spring and summer. The company has instituted price increases over a broad range of products to cover higher costs, and expects a resumption of positive earnings comparisons in the second half, with EPS from operations for the April 2007 fiscal year projected at \$0.70-\$0.78, versus \$0.67 last year. The company's underlying earning power is in the \$1.00 per share area, assuming an eventual full margin recovery in consumer foods to past levels. Moreover, the major expansion of DLM's position in pet foods is a positive development, in view of the much higher profit margins, stronger growth, and greater innovation opportunities in that field. We continue to view DLM as one of the more interesting investment ideas in the food industry, based on management, business mix, earnings potential and valuation. Rated "1" (Strong Buy), 12-month target price \$14-\$15.

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Cost increases for ingredients, packaging and transportation have had a significant impact on DLM's **Consumer Products** businesses over the past few years, and while the company has been diligent about raising prices, there is always a lag in realizing the full benefit, and margins have eroded. For the six months ended in October, sales in this segment were 2% below a year ago, reflecting a negative consumer reaction to higher prices, but operating income declined 16%. We calculate that the operating margin in this \$2.1 billion a year segment, which includes canned and jarred fruits and vegetables as well as canned and pouch-packed tuna, was 9.4% of sales in the latest 12 months, down from 12.2% in the same period three years ago. Some of the added costs, especially for agricultural commodities, will eventually reverse, while management's continuing emphasis on pricing and expense controls over time should offset the cost of those inputs that remain high. We calculate that a full margin recovery in Consumer Products would add \$0.20 per share to DLM's current earning power.

The smaller but more profitable segment, **Pet Products**, including the two recent acquisitions, is now estimated to be a \$1.3 billion a year business, making DLM the second largest company in that field. Profit margins in this segment also narrowed in F2005, but they showed a healthy rebound in F2006, a trend that has continued this year. In the first half of F2007, which included Milk-Bone's operations for only four months, Pet Products reported growth of 44% in sales and 63% in profits, despite increased competitive activity in dry dog food, and in the October quarter alone, pet foods contributed more to operating income than consumer foods for the first time in history. The operating margin for the six months was 15.5%, up from 13.7%. Management expects further profit improvement as the new businesses are fully integrated with DLM's existing operations.

Another impact from the acquisitions can be seen in interest expense, which for the six months through October was \$73.4 million (60% of operating income), compared with \$44.1 million (35%) a year ago. Total debt, net of cash, was \$2.3 billion, up from \$1.3 billion a year ago, clearly attributable to the company's net cash outlay of \$1.3 billion for acquisitions thus far in F2007. Higher interest expense is the principal reason that DLM reported flat EPS, before one-time items, for the six months ended October, despite a 20% increase in operating income. The company generates a substantial amount of excess cash, and as in the past, we expect that those funds will be applied largely to debt repayment. The higher interest costs add to the company's earnings leverage, but that can work to the investor's advantage if operating income rises over the next several years, as we expect it will.

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.

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*	65%	0%
Hold	35%	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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