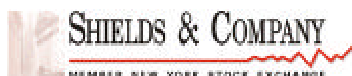

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MAY 18, 2004

COMPANY SUMMARY
Tuesday, May 18, 2004

Speaker: Bob Cummins

Food Industry Comment: Recommended Stocks

Many of the food companies have faced challenging business conditions over the past several quarters. The improving economy has been a plus, as have favorable exchange rates, but significant price inflation across a broad range of agricultural commodities, as well as packaging materials and energy, has increased their costs and put pressure on their margins. In addition, the popularity of low-carbohydrate diets has reduced demand for such products as pasta, baked goods, breakfast cereals, snack foods, cookies and crackers, and many types of frozen foods. At the same time, it has led to increased consumption of meats, poultry, eggs, seafood, cheese and other dairy products, but that in turn has further accentuated the cost pressures for the companies that use those commodities as ingredients.

Despite these difficulties, 12 of the 16 food companies we follow, including seven of the nine leading packaged-foods marketers, reported increased earnings per share for their most recent quarters. Six achieved double-digit growth, namely **Kellogg** (+33%), **PepsiCo** (+15%), **Hershey Foods** (+12%) among the brand-name leaders, **SYSCO** (+15%) in foodservice distribution, and **Flowers Foods** (+75%) and **Smucker** (+12%) in the mid-cap category. **Sara Lee**, **Dean Foods** and **Del Monte Foods** showed 7%-8% gains. Only four companies, **Kraft** (-9%), **General Mills** (-4%), **Performance Food Group** (-54%), and **Sensient Technologies** (-20%), earned less than in their prior-year periods.

The food companies' managements have moved quickly to deal with the problems of increased costs and changing consumer tastes, by instituting price increases and cost reduction steps, as well as by introducing new lower-carb products. We expect that further price hikes will be taken as needed. In addition, the problem of commodity price inflation should be self-correcting over time, as farmers increase their production to take advantage of the high prices. It has been our experience during past periods of cost inflation that, while there may be a lag, the brand-name companies eventually are able to pass on the full increases to consumers, and that in fact inflation can be a blessing in disguise, since as commodity prices return to normal, wholesale and retail food prices seldom go back to their previous levels.

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See last page of report for important disclosures and Analyst's Certification.

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As shown in Table 1, most of the food stocks gained in price in 2003, but the average rise of 13% for our universe of companies was only half that of Standard & Poor's 500. This year, the reverse has been true, as the S&P for 2004 to date is down 2%, while the food group shows average appreciation of 4% (7% for the leading packaged-foods manufacturers alone), despite the earnings issues discussed above. Twelve of the 16 companies listed show gains since January 1st, while only four are down. Its is not surprising that the three best market performers, **PepsiCo** (+17%), **Hershey** (+17%), and **Kellogg** (+10%), are among the companies reporting the strongest earnings growth recently, or that three of the four experiencing price declines, **Kraft** (-3%), **Performance Food Group** (-6%), and **Sensient** (-1%), are among the few whose earnings are down. **Del Monte Foods** and **Smucker** show healthy year-to-date appreciation of 8%, while gains of 6% for both **ConAgra Foods** and **Sara Lee** suggest increasing recognition by investors of the positive strategic changes taking place in both companies and their improving earnings prospects.

Apart from normal market rotation, this year's absolute and relative performance of the food stocks may reflect recognition by investors that the market environment over the balance of this decade is likely to be markedly different from that of the late 1990s, when the S&P 500 index compounded at 26% a year, fuelled by dramatic appreciation in the shares of companies that either no longer exist, are now in Chapter 11, or trade today at a fraction of their old highs. An example we like to cite (admittedly an extreme one) is **Cisco Systems** (CSCO - $21), which trades at the same price as in December, 1998, having made a round-trip to $82 in the interim, in contrast to **SYSCO Corporation** (SYY-$38), which ended 1998 at $13.70, and since then has nearly tripled in price, while increasing its earnings and dividends at double-digit rates every year, and selling at a new high in every year but 2001. After the boom-and-bust experience of the past decade, investing in conservative, moderate-growth companies with predictable earnings, strong finances, and steadily rising dividends, at reasonable valuations, may be regaining popularity.

As indicated by the table, the leading packaged-foods companies currently sell at an average multiple of 17.6 times estimated calendar 2004 earnings, while the average for our food universe overall is 17.3 times, in both cases representing small premiums to the 16.8 times for the S&P. On the other hand, many of the stocks we are recommending sell at discounts to the S&P. Moreover, the average yield for the 13 food companies that pay dividends is 2.4%, versus 1.8% for the S&P, and most of the companies are not only raising their dividends every year, but are increasing their payout ratios in view of the more favorable provisions of the new tax law.

The comments below summarize our views on the stocks we are recommending for purchase. Based on valuations as well as timeliness, we are particularly emphasizing **Sara Lee** and **General Mills** among the large-cap companies, and **Del Monte Foods** and **Performance Food Group** in the mid-cap category.

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Leading Brand-Name Food Companies

ConAgra Foods (CAG- $28) has largely completed the transition from a broadly-based, commodity-driven, low-margin food industry conglomerate to a highly focused marketer of brand-name packaged foods. Its annual sales of $12 billion in that field make CAG America's second largest packaged-foods company, after Kraft, with $20 billion, and its many well-established brands have strong consumer recognition and loyalty across the country. CAG is also strong financially, with significant free cash flow from both operations and asset sales, and is in the midst of a $1 billion share repurchase program. Going forward, management will continue its programs to increase efficiency, accelerate product innovation, and expand advertising and marketing activity. We believe these efforts will lead to stronger top-line growth, an improved product mix, a further widening of the profit margin, faster and more consistent earnings progress, and a higher market valuation. The shares despite recent strength sell at a moderate valuation, and the 3.7% yield is an added attraction. Rated "1" (Strong Buy), 12-month target price $32-$33. Recent comments: 3/26/04.

General Mills (GIS-$ 46) has successfully completed the integration of Pillsbury, which was acquired 2 1/2 years ago, and is enjoying significant cost savings from the combination of the two companies. In addition, as we expected, the PSY brands are beginning to benefit from GIS's proven product innovation and marketing expertise, and we remain confident that the broadening of the company's product and geographic scope has enhanced its potential for sales and earnings growth. Earnings were down slightly in F3Q (February), due to rising commodity costs and the low-carb phenomenon, but volume and profits are expected to strengthen in F4Q, and we are bullish on the outlook for F2005. Historically, GIS has been one of the most successful and fastest-growing companies in the food industry, but disappointments since the PSY deal have created skepticism among investors. We expect that a resumption of more normal growth will lead to healthy expansion of the below-average 15.4 P/E multiple. GIS is one of our best buy ideas at this time. Rated "1", target $55-$56. Recent comments: 2/27, 3/19/04.

Heinz (HNZ - $37) is pursuing an aggressive strategy to accelerate sales and earnings growth by stepping up new product activity, increasing brand-name marketing, gaining productivity, and strengthening its product mix through selective acquisitions and divestitures of noncore businesses, as well as recruiting talented management people from outside the company. The December 2002 sale of several large U.S. businesses to Del Monte was a major step in HNZ's revitalization. The "new" HNZ possesses all of the key strengths that characterize a successful packaged-foods company, including strong brands in attractive product categories, a record of successful product innovation, high profit margins, significant international representation (62% of sales), a conservative balance sheet, and substantial free cash flow. We believe these strengths will become increasingly apparent to investors over time. A modest P/E ratio and a 3.1% yield on the recently-increased dividend make HNZ an attractive value. In addition, following its recent housecleaning, HNZ could become a merger candidate. Rated "1", target $44-$45. Recent comments: 3/5/04.

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PepsiCo (PEP-$ 54) is one of the outstanding growth companies in the consumer goods area, with astute, innovative management, a strong marketing orientation, and well-established leading brands in attractive food and beverage categories with above-average potential in the U.S. and around the world. It also has a virtually debt-free balance sheet and generates substantial amounts of excess cash, which led management recently to announce a 44% dividend increase and an expanded share buyback program. EPS increased 15% in 1Q, and we look for another year of double-digit EPS growth in 2004. We are confident that PEP's growth over the long term will continue to exceed that of most other worldwide consumer packaged goods marketers. Despite a premium multiple, the shares do not appear overvalued, considering the quality and dependability of the company, and we continue to recommend PEP for long-term investors. Rated "1", target $60-$61. Recent comments: 4/23/04.

Sara Lee (SLE-$23) reported gratifying results for F3Q (March) that not only exceeded expectations, but clearly show that the company is on the uptrend again. Four of the five business segments achieved strong increases in operating income to new highs for the period, despite cost inflation and higher pension costs. Apparel, while down from a year ago, showed sequential improvement compared with the December quarter, counter to the normal seasonal trend, and is on track to resume earnings growth in F4Q. Moreover, SLE's F3Q results demonstrate the beneficial impact of management's strategic plan, which includes reducing costs, increasing innovation and marketing support for the key brands, emphasizing product mix rather than sheer volume, and maximizing cash generation. We expect healthy EPS growth in F4Q and in fiscal 2005, and believe the result will be increasing recognition of SLE as a well-managed, successful worldwide consumer goods marketer. We also look for another increase in the $0.75 annual dividend in August. At 12.8 times earnings, with a 3.3% yield, SLE is one of the cheapest stocks we follow, and it continues to be one of our best large-cap buy ideas. Rated "1", target $28-$29. Recent Comments: 2/27, 4/27/04.

Foodservice Distributors

SYSCO Corporation (SYY -$38), the leading marketer and distributor of food and related supplies to restaurants and other foodservice operators, reported strong growth of 10% in sales and 15% in EPS for F3Q (March), marking its 21st consecutive quarter of double-digit earnings progress. With annual sales of $28 billion, SYSCO nevertheless still has only a 13% share of the North American foodservice market, with ample room to continue to grow at the expense of smaller and weaker competitors. Its unusually capable management, efficient infrastructure, sophisticated business strategies, and sizable free cash flow all point to continuing earnings growth at a rate well in excess of sales. We believe annual EPS growth of 14%-15% is sustainable over the foreseeable future, including the benefit of steadily expanding margins, as well as share repurchases. We regard SYSCO as the premier large-cap growth company in the food industry, and despite a generous multiple of 25 times we expect that it will continue to show attractive appreciation for its holders. Rated "1", for long-term investors, target $44-$45. Recent comments: 3/26, 4/30/04.

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Performance Food Group (PFGC- $34), which is growing even faster than SYY, ranks third in foodservice distribution, and is also a leading marketer of branded prepackaged produce through supermarkets. Its Fresh Express produce business and its chain restaurant distribution division are national in scope, while its broadline division is still regional, but is expanding rapidly through acquisitions. PFGC appears to be making good progress in resolving the issues that led to disappointing earnings in 2003 and, where necessary, making changes in its business practices to protect against their being repeated. While 1Q sales were strong, up 15%, EPS were below the prior year, as expected, but management remains confident that earnings growth will resume in 2Q. Year-to-year gains in the second half should be particularly strong, based on easy comparisons, continued healthy sales growth, and increasing efficiency. PFGC remains one of our favorite mid-cap growth companies, in view of its attractive business dynamics and our confidence in management. Although the shares have recovered from their low, they remain 17% below last year's high. We reemphasize our "1" rating and our 12-month target price of $43-$44, or 19-20 times full-recovery earnings in 2005, which we estimate at $2.20 per share, up from $1.70 this year. Recent comments: 3/9, 5/7/04.

Special Situations

Dean Foods (DF-$34), the leading dairy products processor and marketer, is coping successfully with sharply rising commodity prices, while continuing to achieve strong growth for its proprietary branded products, which achieved 1Q volume growth of 28%, adjusted for acquisitions, led by Silk soymilk and Horizon organic products. Management expects cost pressures to have an adverse impact on earnings in the June quarter, but looks for a resumption of healthy gains in the second half, when milk costs are expected to be well below the present record levels. We have a high degree of confidence in the Dean Foods management and its ability both to carry out its long-term growth plans successfully, and also to guide the company through difficult periods such as the present with minimum disruption to the bottom line. This continues to be one of the most dynamic companies in the food industry, and despite the near-term uncertainties, we maintain our "1" rating, with a $41-$42 target price. Recent comments: 2/27, 5/7/04.

Del Monte Foods (DLM - $11) - We are pleased by DLM's successful integration of the former Heinz product lines, acquired in December, 2002, and even more by management's implementation of product and marketing strategies designed to achieve the maximum long-term potential of the newly acquired brands in the categories of pet foods, pet snacks, tunafish, soup, and baby foods. Results for F3Q (January) were at the high end of expectations, and results for F4Q (April), to be released in June, are expected to be the first to reflect significant benefits from the merger, with EPS up 40% - 60%. We expect strong EPS progress in F2005 that should drive the stock to new highs. DLM is modestly valued at only 10 times earnings, and in our opinion is unusually attractive for purchase. Rated "1", target $14-$15, or 12-13 times projected calendar 2005 EPS. Recent comments: 3/9/04.

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Sensient Technologies (SXT -$19.50) is a leading producer of flavors, fragrances and colors for industrial applications. It has attractive technology-driven businesses, proprietary products, strong relationships with blue-chip customers around the world, and attractive profit margins, but it also has a record of periodic earnings disappointments that have eroded investors' confidence and held down its valuation. The March quarter was its third straight period of declining EPS, and we expect one more quarter of weakness before easier comparisons and corrective steps by management lead to a resumption of earnings growth in the second half. That in turn should result in a better stock market performance, and we expect that over the long term SXT will likely be acquired by a larger company, presumably at a healthy premium. That prospect, coupled with a modest multiple of 12.2 times depressed earnings and a 3.1% dividend yield, make SXT an attractive idea for patient investors. Rated "2" (Buy), target $22-$23 as a going concern. Recent comments: 3/5, 4/20/04.

J.M. Smucker (SJM - $49), added to our coverage last month, was a successful but relatively small, family - controlled food company until it acquired the Crisco and Jif brands from Procter & Gamble for stock on June 1, 2002. The transaction more than doubled the company's sales and its shares outstanding, and proved highly accretive to EPS, which increased 51%, before one-time items, in the April 2003 fiscal year. In March, 2004, SJM announced a further expansion move, through the planned acquisition of International Multifoods for stock, cash, and the assumption of debt. IMC, whose brands include Pillsbury (shared with General Mills), Martha White, Hungry Jack, and Pet in the U.S., and Robin Hood and Bick's in Canada, will increase SJM's annual sales by another 60% (to $2.4 billion), and add 15% to its shares outstanding (to 58 million, or $3 billion in market value). We expect this acquisition to be a success as well, although the earnings benefits are likely to be more gradual. We consider Smucker an attractive investment idea. Our rating of "2" (Buy) reflects its relatively high valuation and the risk that IMC's earnings, which were weak in the past year, could continue disappointing over the near term. We would consider upgrading the stock on any weakness. Target $60-$61. Recent comments: 4/16/04.

(Table 1 Attached)

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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. I have a position in the shares of CAG, GIS, HNZ, PEP, SLE, PFGC, SYY, DF, DLM, SXT and SJM. Other reports issued by me are: ConAgra Foods ($26.70) 3/26/04-Strong Buy; General Mills ($46.50) 3/19/04-Strong Buy; Del Monte Foods ($11.10) 3/9/04-Strong Buy; PepsiCo ($54.60) 4/23/04-Strong Buy; SYSCO Corporation ($39) 3/26/04-Strong Buy; Sara Lee ($23.60) 4/27/04-Strong Buy; Sensient Technologies ($21.50) 4/20/04 -Buy; Performance Food Group ($35) 5/7/04- Strong Buy; Dean Foods ($35) 5/7/04- Strong Buy; Heinz ($38) 3/5/04-Strong Buy; J.M. Smucker ($51) 4/16/04-Buy.

Guide to Investment Ratings:

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.
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.
Unless otherwise specified, the time frame for price targets included in this report is 12 months.

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