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FOOD STOCK SUMMARY
Tuesday, December 14, 2004

Speaker: Bob Cummins

Food Industry Comment: Year-End Overview

The food stocks in general have performed well during 2004, and especially in the fourth quarter, when the nine leading packaged-foods issues have shown average appreciation of 7%, and the 16 stocks in our overall food universe have risen an average of 8%, exceeding the 7% advance for the S&P 500 (Table 1). Among the large brand-name companies, **Hershey Foods** has led the way in 4Q, with an 18% gain, while **Campbell Soup** and **Kraft Foods** are up 13% and 10%, respectively. In the foodservice sector, **SYSCO** has gained 20%, and **Performance Food Group** 13%, both representing a recovery from depressed prices earlier. **Flowers Foods** is up 16% to a new all-time high, on better than expected earnings. The only food stock that is down for the quarter is **Del Monte Foods**, with a 3% decline on reduced earnings guidance by management.

For 2004 to date, the brand-name leaders show an average rise of 12%, driven by the extraordinary 43% gain for **Hershey Foods**, as a result of strong earnings growth and the purchase of a large block of stock from the Milton Hershey School Trust. Excluding HSY, the gain for the group would have averaged 8%, led by appreciation of 14% for **Kellogg**, 11% for **Campbell Soup**, 10% for **Sara Lee**, and 9% for **PepsiCo**. Among the other companies we follow, four of the seven have seen declines in their share prices this year, in each case reflecting earnings shortfalls, but the only substantial drop is the 26% for **Performance Food Group**, whose earnings are down sharply, especially in the produce segment. Our food stock universe shows an average gain of 6% for the year to date, just short of the 7% rise for the S&P.

Table 2 traces the monthly performance of the S&P Packaged Foods index with the 500 over the past four years. The Foods outperformed in 2001 and 2002, by showing smaller declines than the 500, but they were overshadowed in 2003 by the strong appreciation for the market as a whole. In 2004, on the other hand, the food stocks had moved decisively ahead of the 500 by the end of April, and have maintained that advantage ever since, recording 10.7% appreciation through November, nearly twice the 5.6% gain for the broader index. We should note that our universe of food stocks does not coincide precisely with the makeup of the S&P Packaged Foods index (for example, **PEP**, **PFGC** and **SYY** are not included), and that the stocks in the index are weighted by size.

(Continued)

Table 1: FOOD STOCK SUMMARY - Prices, Earnings, Dividends

	FY	Com. Shs. (mil.)	Price Dec. 13 2004	Price Change Since Oct. 1	Price Change 2004 to Date	12 Mos. Range	Earnings Per Share 2003	Earnings Per Share 2004E	Earnings Per Share 2005E	Cal. Year P/E 2004E	Cal. Year P/E 2005E	Ind. Divd.	Yield	Rating	12-Month Target
Nine Leading Packaged-Foods Companies															
Campbell Soup (CPB)	July	409.0	30	+13%	+11%	30-25	$1.52	$1.58 A	$1.68	18.2	16.9	$0.68	2.3%	3	
ConAgra Foods (CAG) (c)	May	517.0	27	+5	+2	30-25	1.36 c	1.49 A	1.62	17.4	15.9	1.09	4.0	1	32-33
General Mills (GIS)	May	379.0	47	+5	+4	49-43	2.65	2.85 A	2.90	16.9	14.7	1.24	2.6	1	53-54
Heinz (HNZ) (bc)	April	350.6	38	+5	+3	39-35	2.03	2.20 A	2.37	16.5	15.0	1.14	3.0	1	44-45
Hershey Foods (HSY)		249.6	55	+18	+43	56-37	1.80	2.02	2.23	27.2	24.7	0.88	1.6	3	
Kellogg (K)		412.4	43	+1	+14	45-36	1.92	2.12	2.30	20.3	18.7	1.01	2.3	3	
Kraft Foods (KFT)		1,707.0	35	+10	+8	35-29	2.01	1.88	2.12	18.6	16.5	0.82	2.3	3	
PepsiCo (PEP)		1,727.0	51	+5	+9	56-45	2.07	2.30	2.58	22.2	19.8	0.92	1.8	1	60-61
Sara Lee (SLE)	June	790.0	24	+4	+10	24-20	1.50	1.64 A	1.68	14.4	13.0	0.75	3.1	1	28-29
Average				+7%	+12%					19.1	17.2		2.6%		
Foodservice Distributors															
Performance Food Group (PFGC)		46.5	27	+13	(26)	39-21	1.51	1.25	1.75	21.6	15.4	-	-	1	34-35
SYSCO (SYY)	June	638.2	36	+20	(4)	41-29	1.18	1.37 A	1.51	25.4	22.1	0.60	1.7	1	44-45
Other Companies															
Dean Foods (DF) (g)		155.9	32	+5	(4)	38-28	2.05	2.02	2.30	15.8	13.9	-	-	1	38-39
Del Monte Foods (DLM) (cd)	April	209.8	10.2	(3)	(3)	12- 9	0.83	0.89 A	0.90	11.5	9.9	-	-	1	14-15
Flowers Foods (FLO) (cg)		44.7	30	+16	+17	32-21	1.15	1.34	1.45	22.4	20.7	0.50	1.7	3	
Sensient Technologies (SXT)		46.6	23	+4	+14	24-18	1.49	1.58	1.80	14.6	12.8	0.60	2.6	2	26-27
Smucker (SJM)	April	58.2	46	+4	+2	53-41	2.19	2.40 A	2.60	18.0	16.2	1.00	2.2	1	54-55
Shields Food Universe Average				+8%	+6%					18.8	16.6		2.4% h		
S&P 500			1198	+7%	+7%		$54.69	$66.99	$73.72	17.7	16.1	$20.44	1.7%		

A Actual. E Estimated. (a) Diluted. Before nonrecurring charges or gains. (b) All figures adjusted for DLM spinoff. (c) Continuing operations. (d) EPS are pro forma for acquisition and related financing. (ne) No estimate.
(g) Adjusted for split. (h) Excludes non-dividend paying companies.

(FOOD STOCK SUMMARY TABLE 1.XLS/12/10/04)

Ratings: **1- Strong Buy; 2-Buy; 3-Neutral; 4-Sell; NR-Not Rated.**

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Table 2: 2001-2004 Performance of Food Stocks Versus the Market

	S&P 500			S&P Packaged Foods			
	Closing	% Change		Closing	% Change		
	Price	Month	Year to Date	Price	Month	Year to Date	
2004							
November	1173.82	+3.9%	+5.6%	236.84	+2.8%	+10.7%	-
October	1130.20	+1.4	+1.6	230.43	+2.1	+7.7	+
September	1114.58	+0.9	+0.2	225.68	(0.7)	+5.5	-
August	1104.24	+0.2	(0.7)	227.22	+1.5	+6.2	+
July	1101.72	(3.4)	(0.9)	223.87	(2.9)	+4.6	+
June	1140.84	+1.8	+2.6	230.58	+1.2	+7.8	-
May	1120.68	+1.2	+0.8	227.93	(2.0)	+6.5	-
April	1107.30	(1.7)	(0.4)	232.67	+5.2	+8.7	+
March	1126.21	(1.6)	+1.3	221.07	+0.3	+3.3	+
February	1144.94	+1.2	+3.0	220.32	+4.2	+3.0	+
January	1131.13	+1.7	+1.7	211.35	(1.2)	(1.2)	-
2003							
December	1111.92	+5.1%	+26.4%	213.99	+3.6%	+5.1%	-
November	1058.20	+0.7	+20.3	206.63	+1.6	+1.5	+
October	1050.71	+5.5	+19.4	203.30	+2.8	(0.1)	-
September	995.97	(1.2)	+13.2	197.75	+1.8	(2.9)	+
August	1008.01	+1.8	+14.6	194.20	(1.2)	(4.6)	-
July	990.31	+1.6	+12.6	196.60	(1.2)	(3.4)	-
June	974.50	+1.1	+10.8	198.99	(0.4)	(2.2)	-
May	963.59	+5.1	+9.5	199.80	+7.9	(1.8)	+
April	916.92	+8.1	+4.2	185.10	+0.8	(9.1)	-
March	848.18	+0.8	(3.6)	183.54	(1.3)	(9.8)	-
February	841.15	(1.7)	(4.4)	185.87	(5.4)	(8.7)	-
January	855.70	(2.7)	(2.7)	196.57	(3.4)	(3.4)	-
2002							
December	879.82	(6.0)%	(23.4)%	203.56	+1.8%	(0.1)%	+
November	936.31	+5.7	(18.4)	200.05	+4.6	(1.8)	-
October	885.76	+8.6	(22.8)	191.21	+1.9	(6.1)	-
September	815.28	(11.0)	(29.0)	187.67	(3.7)	(7.9)	+
August	916.07	+0.5	(20.2)	194.88	(1.0)	(4.3)	-
July	911.62	(7.9)	(20.6)	196.84	(5.8)	(3.4)	+
June	989.81	(7.2)	(13.8)	208.99	(0.7)	+2.6	+
May	1067.14	(0.9)	(7.1)	210.55	+1.0	+3.4	+
April	1076.92	(6.1)	(6.2)	208.49	+3.6	+2.3	+
March	1147.39	+3.7	(0.1)	201.32	(0.4)	(1.2)	-
February	1106.73	(2.1)	(3.6)	202.16	(0.1)	(0.8)	+
January	1130.20	(1.6)	(1.6)	202.30	(0.7)	(0.7)	+
2001							
December	1148.09	+0.8%	(13.0)%	203.72	+3.2%	(0.6)%	+
November	1139.46	+7.5	(13.7)	197.44	+1.9	(3.7)	-
October	1059.78	+1.8	(19.7)	193.81	(0.1)	(5.5)	-
September	1040.95	(8.2)	(21.2)	193.99	(4.1)	(5.4)	+
August	1133.59	(6.4)	(14.1)	202.28	+5.2	(1.4)	+
July	1211.23	(1.1)	(8.3)	192.30	+3.2	(6.2)	+
June	1224.42	(2.5)	(7.3)	186.33	(0.2)	(9.1)	+
May	1255.82	+ 0.5	(4.9)	186.70	+0.9	(8.9)	+
April	1249.46	+7.7	(5.4)	185.03	(0.8)	(9.7)	-
March	1160.33	(6.4)	(12.1)	186.52	(1.9)	(9.0)	+
February	1239.94	(9.2)	(6.1)	190.13	(2.7)	(7.3)	+
January	1366.01	+3.5	+3.5	195.41	(4.7)	(4.7)	-

+ Foods outperformed for the month. (FSUM\S&P.xls -12/13/04)

- Foods underperformed for the month.

Table 3: S&P 500 and S&P Packaged Foods, 1965-2004

	S&P 500		S&P Pkgd. Foods		Pkgd. Foods
	Closing Price	Annual Change	Closing Price	Annual Change	Relative Performance
2004 YTD	1173.82	+5.6%	236.84	+10.7%	+5.1p.p.
2003	1111.92	26.4	213.99	+3.6	(22.8)
2002	879.82	(23.4)	203.56	(0.1)	+23.3
2001	1148.09	(13.0)	203.72	(0.6)	+12.4
2000	1320.28	(10.1)	205.05	+23.3	+33.4
1999	1469.25	+19.5	166.30	(23.1)	(42.6)
1998	1229.23	+26.7	216.25	+6.2	(20.5)
1997	970.43	+31.0	203.66	+40.5	+9.5
1996	740.74	+20.3	144.98	+15.7	(4.6)
1995	615.93	+34.1	125.27	+24.7	(9.4)
1994	459.27	(1.5)	100.44	+8.8	+10.3
1993	466.45	+7.1	92.31	(10.4)	(17.5)
1992	435.71	+4.5	103.04	(2.4)	(6.9)
1991	417.09	+26.3	105.57	+42.7	+16.4
1990	330.22	(6.6)	74.00	+8.3	+14.9
1989	353.40	+27.3	68.34	+29.2	+1.9
1988	277.70	+12.4	52.88	+33.0	+20.6
1987	247.10	+2.0	39.75	+2.9	+0.9
1986	242.20	+14.6	38.62	+30.2	+15.6
1985	211.30	+26.4	29.67	+59.3	+32.9
1984	167.20	+1.4	18.63	+16.0	+14.6
1983	164.90	+17.3	16.06	+21.1	+3.8
1982	140.60	+14.7	13.26	+32.9	+18.2
1981	122.60	(9.7)	9.97	+15.2	+24.9
1980	135.80	+25.9	8.65	+2.7	(23.2)
1979	107.90	+12.3	8.42	(0.3)	(12.6)
1978	96.11	+1.1	8.44	(6.0)	(7.1)
1977	95.10	(11.5)	8.98	(8.0)	+3.5
1976	107.50	+19.2	9.76	+12.1	(7.1)
1975	90.19	+31.5	8.71	+46.1	+14.6
1974	68.56	(29.7)	5.96	(17.9)	+11.8
1973	97.55	(17.4)	7.26	(24.2)	(6.8)
1972	118.10	+15.7	9.57	+9.7	(6.0)
1971	102.10	+10.8	8.73	+3.7	(7.1)
1970	92.15	+0.1	8.42	+3.4	+3.3
1969	92.06	(11.4)	8.14	(7.7)	+3.7
1968	103.90	+7.7	8.82	+14.3	+6.6
1967	96.47	+20.1	7.72	+26.0	+5.9
1966	80.33	(13.1)	6.13	(26.0)	(12.9)
1965	92.43		8.29		

Compound Annual Gain:

	S&P 500	S&P Pkgd. Foods	Pkgd. Foods Relative Performance
1965-2004 (39 yrs.)	+6.6%	+8.9%	+2.3p.p.
1975-2004 (29 yrs.)	+9.1	+12.0	+2.9
1985-2004 (19 yrs.)	+9.2	+11.3	+2.1
1995-2004 (9 yrs.)	+7.0	+7.0	0.0

(fdsum/SPFOODS.xls/12/13/04)

Table 4: Leading Food Stocks - Quarterly Price Changes

	July-Sept. 2004	April-June 2004	Jan.-March 2004	Oct.-Dec. 2003	July-Sept. 2003	April-June 2003	Jan. - March 2003	Oct.-Dec. 2002	July-Sept. 2002
Altria Group (g)	(6)%	(8)%	0%	+24%	(4)%	+52%	(26)%	+4%	(11)%
Amer. Italian Pasta	(14)	(24)	(5)	+8	(7)	(4)	+20	+1	(30)
Archer Daniels Midland	+1	(1)	+11	+16	+2	+19	(13)	(1)	(2)
Aurora Foods	f	f	f	f	f	(8)	(51)	+20	(57)
Bunge	+3	(3)	+22	+20	(4)	+14	+2	+2	+15
Campbell Soup	(2)	(1)	+2	+1	+8	+17	(11)	+6	(20)
Chiquita Brands (New)	(17)	0	(7)	+27	+22	+32	(17)	(14)	(14)
ConAgra Foods	(5)	+1	+2	+24	(10)	+18	(20)	+1	(10)
Corn Products Intl.	(1)	+16	+16	+8	+6	+3	(3)	+5	(8)
Dean Foods (New)(a)	(20)	+12	+2	+6	(1)	+10	+16	(7)	+7
Del Monte Foods	+3	(10)	+8	+19	(1)	+18	(3)	(6)	(31)
Dial	c	c	c	+32	+11	0	(5)	(5)	+7
Dole Food	c	c	c	c	c	c	c	+12	+1
Flowers Foods	(1)	0	+2	+13	+15	+8	+40	(14)	(12)
Fresh Del Monte	(1)	(2)	+8	(3)	(4)	+68	(19)	(26)	+2
General Mills	(6)	+2	+3	(4)	(1)	+4	(3)	+6	+1
Hain Celestial	(2)	(18)	(5)	+28	+14	+6	(1)	+4	(21)
Heinz	(8)	+5	+2	+6	+4	+13	(11)	+9h	(19)
Hershey Foods	+1	+12	+8	+6	+4	+11	(7)	+9	(1)
Hormel Foods	(14)	+6	+14	+12	(3)	+12	(9)	+7	(9)
Intl. Multifoods	c	c	+37	(23)	+2	+19	(9)	+8	(25)
Interstate Bakeries	f	(5)	(20)	(4)	+17	+21	(31)	(43)	(8)
Kellogg	+2	+7	+3	+14	(3)	+12	(11)	+3	(7)
Kraft Foods	0	(1)	(1)	+9	(9)	+15	(28)	+7	(11)
McCormick	+1	+2	+11	+10	+1	+13	+4	+2	(11)
PepsiCo	(10)	0	+16	+2	+3	+11	(5)	+14	(23)
Performance Food Group	(11)	(23)	(5)	(11)	+10	+21	(10)	0	0
Ralcorp Holdings	+3	+16	(3)	+13	+11	(4)	+4	+18	(32)
Sara Lee	(1)	+5	+1	+18	(2)	+1	(17)	+23	(11)
Sensient Technologies (b)	+1	+15	(6)	(6)	(9)	+15	(11)	+6	(7)
Smithfield Foods	(15)	+8	+31	+8	(16)	+30	(9)	+27	(18)
Smucker	(3)	(13)	+17	+7	+6	+14	(12)	+8	+8
SYSCO	(17)	(8)	+5	+14	+9	+18	(15)	+5	+4
Tyson Foods	(24)	+16	+36	(6)	+33	+37	(31)	(4)	(25)
Unilever	(16)	(1)	+7	+10	+10	(9)	(4)	+4	(8)
Wrigley	0	+7	+5	0	0	0	+3	+11	(11)
Average	(6)%	0%	+5%	+8%	+3%	+11%	(6)%	+4%	(11)%
S&P 500	(2)%	+3%	(1)%	+12%	+2%	+15%	(4)%	+8%	(18)%

(a) Formerly Suiza Foods. (b) Formerly Universal Foods. (c) Company was acquired. (d) Price change since IPO. (f) Company declared bankruptcy.
(g) Formerly Philip Morris. (h) Adjusted for spinoff. fsum/LEADING12/13/04

(Continued)

As shown by Table 3, outperformance by the food stocks is not a recent phenomenon. For the sake of brevity, we have shown the annual comparisons only since 1965, although similar data going back to the 1930s (available on request) show the same pattern. The stocks may underperform severely in boom times like the late 1990s, but they tend to hold their value during the subsequent bear markets, resulting in what we call the “tortoise and hare” effect. Thus, for the longest period shown, 1965-2004, the Foods appreciated 8.9% a year, a 2.3 percentage point advantage over the S&P 500, at 6.6%. Moreover, the November closing price of 236.84 for the Packaged Foods was a new high, while the 500 at 1173.82 was still 20% below the record year-end closing in 1999.

Earnings Growth Continues

This year’s positive performance by most of the food stocks is gratifying, inasmuch as the industry over the past 12 months has faced virtually unprecedented cost inflation for inputs ranging from agricultural commodities to packaging, fuel and trucking rates. The companies have been successful in raising prices, but the pressures have continued. It is gratifying to see from their recent results, as summarized in Table 5, that most of the companies have continued to show earnings progress in the face of adversity, and that in fact margins for many in the group have continued to strengthen. On a median basis, in the second calendar quarter, the nine leading packaged-foods manufacturers leveraged a 4% sales gain into growth of 10% in pretax income and 11% in EPS, with only **Campbell Soup** and **Kraft Foods** reporting lower earnings. Results in 3Q were similar, with sales, pretax income and EPS rising 5%, 8% and 10%, respectively, and only **General Mills** showing an EPS decline. We are bullish on earnings progress for the group going forward, based on a successful adjustment to higher costs through price increases and gains in productivity, and on recent declines in the prices of many farm commodities as a result of increased production.

Table 6 demonstrates the quarterly sales and earnings trends for the packaged-foods companies over the past 16 years, showing that for the group as a whole, pretax margins have expanded almost without interruption, that most of the time EPS growth has been in the low double digits, and that over the entire period, 4Q-2001 was the only quarter in which the group suffered a year-to-year earnings decline.

(Continued)

Table 5: Nine Leading Packaged-Foods Companies - Trends in Sales & Earnings (% change versus prior year)(a)

	May-July 2004 Quarters					August-October 2004 Quarters				
	Period	Sales	Pre-tax Income	Net Income	E.P.S.	Period	Sales	Pre-tax Income	Net Income	E.P.S.
Campbell Soup	4Q July	(2)%	(7)%	(6)%	(6)%	1Q Oct.	+10%	+8%	+9%	+10%
ConAgra Foods	4Q May (b)	+1	+16	+20	+23	1Q Aug.	+8	+21	+18	+17
General Mills	4Q May (b)	+2	+7	+9	+7	1Q Aug.	+3	(15)	(11)	(11)
Heinz	1Q July	+6	+8	+8	+8	2Q Oct.	+5	+1	+3	+4
Hershey Foods	2Q June	+5	+16	+16	+18	3Q Sept.	+5	+10	+10	+16
Kellogg	2Q June	+6	+12	+16	+14	3Q Sept.	+7	+7	+7	+5
Kraft Foods	2Q June	+5	(13)	(18)	(16)	3Q Sept.	+5	(7)	+2	+4
PepsiCo	2Q June	+8	+9	+11	+11	3Q Sept. (c)	+6	+11	+13	+14
Sara Lee	4Q June (b)	+3	+17	+18	+15	1Q Sept. (d)	+4	+16	+13	+14
Median		+4%	+10%	+12%	+11%		+5%	+8%	+9%	+10%

(a) Before nonrecurring gains and charges. Continuing operations where applicable.
(b) Adjusted to reflect comparable weeks. (c) Excludes tax credit.
(d) Excludes tobacco contingency payment.

fsum/trend 12/10/04

Table 6: Leading Packaged-Foods Companies - Quarterly Median Trends in Sales & Earnings (a)

	Sales	Pre-tax Income	Net Income	E.P.S.	Sales	Sales	Pre-tax Income	Net Income	E.P.S.
					4Q-96	+6%	+9%	+10%	+12%
3Q-04	+5%	+8%	+9%	+10%	3Q-96	+5	+12	+13	+13
2Q-04	+4	+10	+12	+11	2Q-96	+3	+12	+14	+16
1Q-04	+6	+8	+7	+8	1Q-96	+6	+9	+10	+12
4Q-03	+5	+4	+6	+6	4Q-95	+5	+10	+10	+11
3Q-03	+5	+7	+9	+9	3Q-95	+8	+12	+13	+14
2Q-03	+4	+12	+13	+16	2Q-95	+10	+12	+13	+14
1Q-03	+4	+7	+7	+10	1Q-95	+9	+10	+12	+13
4Q-02	+4	+11	+13	+14	4Q-94	+12	+8	+8	+10
3Q-02	+1	+14	+14	+13	3Q-94	+9	+8	+6	+8
2Q-02	+4	+13	+13	+15	2Q-94	+6	+7	+6	+8
1Q-02	+4	+9	+13	+15	1Q-94	+5	+7	+6	+8
4Q-01	+7	+2	(5)	(6)	4Q-93	+4	+6	+6	+7
3Q-01	+9	+8	+8	+7	3Q-93	+4	+6	+5	+8
2Q-01	+7	+3	+6	+10	2Q-93	+4	+2	+4	+5
1Q-01	+4	(2)	0	+2	1Q-93	+5	+10	+11	+12
4Q-00	+3	+5	+5	+9	4Q-92	+6	+12	+15	+14
3Q-00	+3	+6	+7	+12	3Q-92	+9	+15	+16	+17
2Q-00	+3	+6	+6	+11	2Q-92	+3	+6	+7	+7
1Q-00	+4	+9	+10	+12	1Q-92	+1	+7	+10	+9
4Q-99	+3	+8	+12	+13	4Q-91	+3	+11	+14	+13
3Q-99	+2	+8	+9	+12	3Q-91	+2	+9	+9	+9
2Q-99	+1	+6	+7	+9	2Q-91	+9	+19	+17	+13
1Q-99	+2	+6	+7	+11	1Q-91	+10	+17	+14	+13
4Q-98	(1)	+2	+4	+4	4Q-90	+13	+26	+21	+18
3Q-98	+2	+6	+8	+12	3Q-90	+12	+19	+18	+17
2Q-98	+1	+7	+8	+10	2Q-90	+9	+10	+12	+11
1Q-98	+2	+9	+10	+13	1Q-90	+7	+9	+12	+11
4Q-97	+1	+10	+11	+13	4Q-89	+8	+12	+10	+9
3Q-97	+2	+10	+11	+13	3Q-89	+9	+15	+14	+14
2Q-97	+4	+10	+13	+14	2Q-89	+12	+13	+14	+14
1Q-97	+1	+9	+11	+13	1Q-89	+15	+11	+14	+15

(a) % change versus prior year. Excludes nonrecurring gains and charges.

(FSUM/Quamed.xls12/13/04)

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Cash Flow Is Strong

In addition to consistent earnings growth, another favorable characteristic of the food industry is sizable free cash flow, which not only results in strong balance sheets, but also can be used to enhance earnings growth, through debt reduction, share repurchases, and strategic acquisitions, as well as helping to insure regular dividend increases. In Table 7, we project free cash flow in 2005 for the nine leading packaged foods companies, based on our own definition: net income before nonrecurring items, plus depreciation, amortization, and other noncash charges, net of capital spending, but before dividend payments, acquisitions, financial transactions, and changes in working capital. We would note that in some cases that calculation understates the totals, since many companies are making a concerted effort to generate additional cash by reducing working capital.

It can be seen that projected 2005 free cash flow as we define it represents 6.4% of the group's market capitalization, based on the median for the nine companies. The range is from an impressive 9.5% for **Sara Lee** to only 4.3% for **Hershey Foods** (reflecting its high valuation) and 5.2% for **ConAgra Foods**. While not shown by the table, the deduction of dividend payments would reduce the median figure to 3.8%, which in effect represents the percentage of its shares that the typical food company could repurchase every year, without adding to its debt or reducing its dividend. In this relatively mature industry, the positive impact of share buybacks on EPS growth can be meaningful.

On the other hand, if they chose to use next year's cash flow to reduce debt, and thus save on interest costs, the companies could pay off 26% of their total borrowings, based on the median for the group. For **PepsiCo**, the figure is infinite, since its cash and equivalents exceed its debt. **Hershey Foods** and **Sara Lee** could reduce their net borrowings by 41% and 37%, respectively. At the low end of the range, the figures are only 14%-15% for **ConAgra Foods** and **General Mills**, indicating a higher debt burden relative to cash generated.

The other potential use of excess cash, of course, is increased dividends, and here the numbers clearly indicate that most food companies could pay out significantly more to shareholders if they chose to do so. As shown by the table, on a median basis, projected free cash flow for 2005 represents 260% of current dividend payments. That means a company that is now paying shareholders an annual dividend of $1.00 per share could theoretically raise it to $2.60 if it chose to maintain its present debt level and forego share repurchases. The ratios for **PepsiCo** (325%) and **Sara Lee** (310%) are particularly favorable. Of course, it is highly unlikely that a management would choose to pay out all of its excess cash, but the calculation does show that current dividend rates for most companies are not particularly generous relative to the funds available. It also demonstrates why most of the leading food companies are raising their dividends each year, even when earnings fall short of expectations, and why many in the group have responded to changes in the tax law by announcing larger percentage increases than in the past. In today's market environment, which clearly places a higher emphasis on dividends, the favorable cash flow characteristics of the major food companies are worth noting.

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Table 7 indicates that the typical packaged-foods stock is selling at 15.8 times estimated 2005 free cash flow, lower than the average P/E ratio of 17.2 times, as shown in Table 1. **Sara Lee** is the outstanding value in the group, at only 10.4 times, followed by **Kellogg** at 14.6 times. **ConAgra Foods** and **Kraft Foods**, at 18-19 times, are relatively expensive by this measurement.

Table 7: Nine Leading Packaged-Foods Companies - Summary of 2005 Free Cash Flow

	Year	Est. Free Cash Flow Millions	Est. Free Cash Flow Per Share	% of Market Capitalization	% of Net Debt	% of Current Dividend	Stock Price	Price/ FCF
Campbell Soup	7/05	$760	$1.85	6.2%	23%	270%	30	16.2x
ConAgra Foods	5/05	730	1.40	5.2	14	130	27	19.3
General Mills	5/05	1,160	3.05	6.5	15	245	47	15.4
Heinz	4/05	870	2.50	6.6	23	220	38	15.2
Hershey Foods	12/05	590	2.35	4.3	41	265	55	23.4
Kellogg	12/05	1,210	2.95	6.9	27	290	43	14.6
Kraft Foods	12/05	3,320	1.95	5.6	27	240	35	17.9
PepsiCo	12/05	5,200	3.00	5.9	a	325	51	17.0
Sara Lee	6/05	1,800	2.30	9.5	37	310	24	10.4
Median				6.4%	26%	260%		15.8x

Note: Free cash flow equals net income, depreciation and amortization, and other noncash charges, less capital expenditures, but before dividends, acquisitions, financial transactions, and changes in working capital. Net income excludes nonrecurring gains and losses.

(a) Cash and short-term investments exceed total debt.

(fdsum/free cash flow/12/13/04)

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Recommended Stocks

Leading Brand-Name Food Companies

ConAgra Foods (CAG-$27) over the past two-plus years has successfully completed its strategic program of divesting volatile, low-margin commodity businesses that formerly accounted for nearly half of its sales. Now its entire emphasis is on expanding and strengthening its large, broadly-based brand-name food operations, where margins are higher and profits more predictable. That $12 billion a year business includes many of America's best-known brands, and in our view has the potential for faster sales growth and significantly higher profit margins now that it has been reorganized and is being managed more effectively. We continue to view CAG as one of the most rapidly improving companies in the food industry, with attractive earnings potential over the next several years as management strives to enhance profitability by concentrating on product mix, marketing, customer relationships, operational capabilities, and cost reduction. The company is gradually gaining recognition from investors, and at their April peak the shares sold at their highest price since 1999. Now trading 9% below that level, they remain reasonably priced at 16 times estimated calendar 2005 EPS. Moreover, the recently-increased $1.09 dividend provides a 4.0% yield, the highest in the food industry. CAG is rated "1" (Strong Buy), with a 12-month target price of $32-$33. Recent comments: 6/4, 7/2, 9/24/04.

General Mills (GIS-$47) has successfully completed the integration of Pillsbury, which was acquired three 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. The public offering of Diageo's remaining GIS shares in October has depressed the stock temporarily, but it was a welcome development since it eliminates a long-term uncertainty. Meanwhile, volume trends are off to a strong start in F2005, while pressures from high input costs and promotional expenditures are expected to ease, leading to favorable earnings comparisons. 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 and a static share price. We expect that a resumption of more normal growth will lead to increased confidence and a recovery in the multiple from the present below-average 15 times. Rated "1", target $53-$54. Recent comments: 6/4, 10/8/04.

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Heinz (HNZ-$38) continues to make progress toward achieving management's goal of upgrading the company's performance by increasing product innovation, focusing on its core brands, upgrading its product mix, gaining productivity, increasing working capital turnover, and selectively recruiting talented executives from other consumer goods marketers. Its three largest operating companies, North American Consumer Products, Heinz U.S. Foodservice, and Heinz U.K., are all performing well, despite the inflationary cost pressures that are affecting the entire food industry. Its modest EPS gain of only 4% in the October period reflected reduced earnings for two low value-added businesses in Europe and New Zealand, which may be candidates for divestiture, as well as a one-time accounting adjustment in Italy, which alone reduced EPS by 7%. Management now expects EPS for F2005 to rise only 5%-8%, including the charge, slightly below its earlier projection. Nevertheless, we continue to believe that the strategies in place at Heinz will enhance its sales growth, profit margins, and earnings performance over time, leading to increased recognition as one of the world's most successful brand-name packaged foods marketers. Rated "1", target $44-$45. Recent comments: 5/25, 11/30/04.

PepsiCo (PEP-$51) 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 earlier this year to announce a 44% dividend increase and an expanded share buyback program. The September quarter was PEP's 20th consecutive period of double-digit EPS growth, and we look for another year of similar progress in 2005. We are confident that PEP's growth over the long term will continue to exceed that of most other worldwide consumer packaged goods marketers. PEP typically sells at a premium multiple, reflecting the quality and dependability of the company, but after a 9% decline from the June high, the valuation is a more moderate 20 times our 2005 estimate, representing an attractive buying opportunity. We continue to recommend PEP for long-term investors. Rated "1", target $60-$61. Recent comments: 7/16, 10/1/04.

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Sara Lee (SLE-$24) – We remain confident that this is a steadily improving company whose potential is not yet adequately recognized by the investment community. Its programs to increase operating efficiency, focus marketing efforts on its most promising brands, introduce more value-added products, expand profit margins, and maximize cash flow in our opinion should enable management to achieve its goal of making Sara Lee one of the top-tier consumer products companies over the next five years. We consider the recent management changes particularly constructive. SLE is off to a good start in its June 2005 fiscal year, considering the commodity cost pressure it is seeing in Meats and Branded Apparel. EPS for F1Q (September) were at the high end of the range projected by management, and four of SLE's five business units (all except Meats) reported increased operating income, with Bakery and Household Products particularly strong, and Apparel clearly turning the corner, despite high cotton costs. We look for accelerating earnings progress in the coming quarters. F2006 could see particularly strong earnings growth, in view of prospects for a return to more normal cotton prices. We expect Sara Lee's business strategies to lead over time to a stronger, more consistent earnings performance, and increased recognition by investors. Although trading near their high, the shares remain inexpensive at only 13 times our calendar 2005 estimate, while the newly-increased $0.79 dividend yields an above-average 3.1%. We reemphasize our "1" rating, and are raising our target price from $26-$27 to $28-$29. Recent comments: 8/20, 10/8, 10/29/04.

Foodservice Distributors

SYSCO Corporation (SYY-$36) is not only the leading marketer and distributor of products to restaurants and other foodservice establishments, but also, in our opinion, the premier large-cap growth company in the food industry. SYY has continued to show healthy growth in EPS, in the face of a slump in restaurant industry volume, inflated meat prices, and the impact of the hurricanes in Florida, where SYY has a particularly strong market position. Its favorable performance in a difficult industry environment reflects its continuing emphasis on the most promising customers, a rising percentage of higher-margin SYSCO brand products, increasing operating efficiency, and the use of free cash flow to pay down debt and repurchase shares. The 9%+ EPS increase in the September quarter was an impressive performance under the circumstances, and we continue to expect stronger volume and a resumption of SYY's traditional mid-teens earnings growth as restaurant industry trends return to normal. While the shares have rallied from their September low, they remain below their normal valuation, at 22 times calendar 2005 EPS. We consider SYY a particularly timely buy idea for investors emphasizing quality, dependability, and above-average growth. Rated "1", target price $44-$45. Recent comments: 8/20, 11/5/04.

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Performance Food Group (PFGC-$27) ranks third in foodservice distribution (after Royal Ahold), and is the leading producer of precut salad products for both restaurants and supermarkets. It continues to make good progress in overcoming the problems that have depressed its earnings and its stock price over the past year. In 4Q, despite the slowing of retail category growth for packaged salads that has been evident since 2Q, as well as the absence of last year's extra week, EPS from operations are expected to rise 15%-31% versus depressed prior-year results, marking the first up quarter since 3Q-03. We expect the improving trend to continue in 2005, with each of the three business segments achieving healthy sales and earnings growth, and EPS rising to the $1.75 range, a new all-time high, up from a disappointing $1.25 from operations for the year just ending. The September 16th announcement that PFGC will "explore strategic alternatives" for its $1 billion a year produce operations adds an element of uncertainty, but we do not believe management will dispose of that attractive business unless it can be done on a basis that enhances shareholder value. If it were divested (perhaps through a spinoff to shareholders), management could focus entirely on the foodservice market, where PFGC has significant growth opportunities. The shares, trading 36% below their high, remain reasonably priced at 15 times our 2005 estimate, which still does not reflect peak earning power. Rated "1" for aggressive investors, target $34-$35. Recent comments: 6/25, 8/3, 9/7, 9/28, 11/12/04.

Special Situations

Dean Foods (DF-$32) is the nation's leading processor and distributor of dairy products, and one of the most dynamic companies in the food industry. Management's strategy is to invest the earnings and cash flow from its fresh milk business to build its high-margin Branded Products operations, which have much higher growth potential. That $1.1 billion division, which features the Horizon Organic, Silk, International Delight, Land O'Lakes and Hershey's brands, has shown a strong sales and earnings performance this year, but its gains have been offset by escalating costs in the Dairy division for milk, butterfat, packaging, and fuel, as well as some specific issues in Specialty Foods and in Spain. However, management expects a resumption of double-digit EPS growth in 4Q, resulting in flat results for the year, and an 8%-13% rise to a new high of $2.20-$2.30 in 2005. We feel that could be conservative, especially in view of this year's repurchase of 6% of the outstanding shares. We consider the 2004 setbacks to be strictly temporary, and expect that a resumption of earnings growth will restore confidence in Dean's long-term potential. Unlike most food stocks, the DF shares are down slightly for 2004 to date, and we consider them attractive for purchase at a moderate 14 times 2005 EPS. Rated "1", target $38-$39. Recent comments: 8/6, 9/10, 11/9/04.

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Del Monte Foods (DLM-$10.20) two years ago took a dramatic strategic step when it acquired four major businesses from Heinz for cash and stock, and thus not only increased its annual sales by 2 ½ times (to $3.1 billion), but also expanded its profit margins, strengthened its balance sheet, and enhanced both its stature in the grocery industry and its potential for long-term growth in sales, earnings and cash flow. Since then, management has done a commendable job of integrating the acquired operations, as well as implementing strategies to strengthen and build the newly-acquired product lines. However, the success of these efforts has been somewhat overshadowed by the above-average cost inflation for ingredients, packaging, energy and transportation that has affected the entire food industry. Like its peers, DLM has taken selective price increases where appropriate, but the pressures persist, and EPS from operations for the April 2005 fiscal year are expected to be slightly below last year's $0.89, despite healthy sales growth. While disappointing, that does not change our view that this is a well-managed, emerging company in the food industry that will achieve healthy earnings growth and gain increasing recognition over time. The shares appear attractive for purchase here, selling at the same price as before the announcement of the Heinz deal in June 2002, 13% below their 12-month high, and at only 12 times current earnings, one of the lowest multiples in the industry. We believe patience will be rewarded. Rated "1", target price $13-$14. Recent comments: 6/4, 7/2, 9/14, 12/3/04.

Sensient Technologies (SXT-$23), with annual sales of $1 billion, is a leading supplier of proprietary, technology-based and high-margin color, flavor and fragrance products to a broad list of blue-chip companies around the world. International operations account for 56% of revenues. Besides its traditional food and beverage markets, SXT has broadened its scope to include technical colors, inkjet inks, and products for cosmetics and pharmaceuticals. Several of its businesses are subject to periodic bouts of price competition, leading to temporary pressure on earnings, but EPS have now rebounded to a record high after four straight quarters of decline, and prospects for 2005 are attractive. In addition to growth potential from new products, new markets, an improving product mix, and stringent cost controls, Sensient could also be a candidate for acquisition by a larger company, a development that management would not oppose if the terms were attractive. The shares have rallied on the news of an earnings recovery, and are trading within 5% of this year's high, but they remain reasonably priced at only 13 times our $1.80 estimate for 2005. Rated "2" (Buy), 12-month target price $26-$27 as a going concern. Recent comments: 7/20, 10/22/04.

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J.M. Smucker (SJM-$46) three years ago was a successful but relatively small, specialized marketer of branded foods and industrial products, with annual sales of $700 million and a market capitalization of $800 million. Today, it is a full-fledged, broadly-based powerhouse in the food industry, with sales of $2.2 billion and a $2.5 billion market cap. The first step was the purchase of the Crisco and Jif brands from Procter & Gamble in June, 2002, in an all-stock transaction, the shares being distributed to P&G shareholders. That transaction, which more than doubled the company's size, proved to be highly successful. The next phase was the June, 2004 acquisition of International Multifoods, which increased SJM's sales by more than 50%, and added such well-entrenched brands as Pillsbury, Hungry Jack, Martha White and Pet in the U.S., and Robin Hood and Bick's in Canada. We expect that this acquisition will also be accretive to earnings, and will further enhance future growth potential, in view of cost savings from combining the two companies, as well as the opportunity to reinvigorate the brands that IMC acquired from Diageo in 2001. More recently, SJM has announced plans to sell its U.S. industrial business to focus entirely on brand-name food marketing. Although the shares have regained most of the ground they lost last summer, they remain attractive for purchase at 16 times our $2.84 estimate for calendar 2005, in view of our expectation that earnings growth over the next several years could exceed that of most other food companies. Rated "1", target $54-$55. Recent comments: 7/27, 11/23/04.

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 ConAgra Foods, General Mills, Heinz, PepsiCo, Sara Lee, SYSCO Corporation, Performance Food Group, Dean Foods, Del Monte Foods, Sensient Technologies, and J.M. Smucker. Other reports issued by me are: ConAgra Foods ($26) 9/24/04-Strong Buy; General Mills ($44.80) 10/8/04-Strong Buy; SYSCO Corporation ($35) 11/5/04-Strong Buy; Sara Lee ($23) 10/29/04-Strong Buy; Sensient Technologies ($21.40) 10/22/04-Buy; Performance Food Group ($26.20) 11/12/04-Strong Buy; Dean Foods ($32.50) 11/9/04-Strong Buy; Heinz ($37) 11/30/04-Strong Buy; J.M. Smucker ($44) 11/23/04-Strong Buy; Del Monte Foods ($10.40) 12/3/04-Strong Buy; PepsiCo ($49) 10/1/04-Strong 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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