

FINAL TRANSCRIPT

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DLM - Q3 2009 Del Monte Foods Earnings Conference Call

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PRESENTATION

Operator

Welcome, and thank you for joining Del Monte Foods Company third quarter fiscal 2009 earnings conference call. At this time all participants are in a listen-only mode. After the presentation we will conduct a question-and-answer session. Today's conference is being recorded.

Now I will turn the conference over to Larry Bodner, Senior Vice President, Finance, Investor Relations, and Communications, Del Monte Foods. Thank you. You may begin.

Larry Bodner - *Del Monte Foods Company - SVP - Finance, IR & Corporate Communications*

Good morning, everyone. Thank you for joining us for Del Monte Foods fiscal 2009 third quarter conference call. With me today are Rick Wolford, Del Monte's Chairman and CEO, and Dave Meyers, our CFO. The call today will last one hour. In the interest of time we'd ask you to limit your questions to one per person.

Let me remind everyone that statements made during this conference call, which are not historical facts, including any statements about the Company's targets, beliefs, plans or expectations are forward-looking statements and are based on managements' current plans, estimates and projections. The Company does not undertake to update any of these statements in light of new

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information or future events. Forward-looking statements involve inherent risks and uncertainties and investors should not place undue reliance on them. There are a number of important factors that could cause actual results to differ materially from those contained in such statements. These factors are described in more detail in the earnings release we issued today and in our filings with the SEC.

In October 2008 the Company completed its divestiture of the seafood business, including Starkist. Unless otherwise noted all of the money spent, financial information including in this -- included in this press release excludes the seafood business, which is reported as discontinued operations. Cash flow data (inaudible) share data we will discuss today are internal estimates based on Nielsen grocery share data and Nielsen all-outlet panel data from 13 weeks ended January 25, 2009. Additional all-outlet share data, as well as the basis for our share data are available in the appendix of the presentation, which is available on the Company's website.

Now our Chairman and CEO, Rick Wolford, will take you through our results.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you very much, Larry, and good morning, everyone. I am pleased with Del Monte's strong top and bottom-line Q3 results. These results reflect the strategic pricing and productivity initiatives that we've put in place. This strategy was implemented to offset inflationary pressures that have negatively impacted our earnings performance and recoup some of the margin contraction that we've experienced over the last several years, as our pricing actions have lagged the acceleration of cost inputs. The volume elasticity from the pricing actions we experienced both during Q3 and fiscal year to date have been largely consistent with our expectations. As a result, our pricing actions, combined with our productivity savings, were able to more than offset cost increases in Q3.

Looking at the categories in which we participate, similar to Q2 we continue to see positive overall trends. Our consumer categories, particularly vegetables and tomatoes, indicate that people are making and eating more meals at home. Also, positive pet food and pet snack trends continue. People continue to treat their pets even with the more discretionary soft and chewy snacks. As a result of the current economic conditions, we continue to see consumer migration towards value channels and as well, demonstrating an increased focus on buying on deal and in bigger package sizes. Del Monte's broad distribution footprint ensures that consumers will find our products across all US retail channels and we are carefully managing our trade promotional strategy in light of increased focus on buying on promotion.

Similar to Q2 and largely as anticipated, we continue to see higher levels of competitive branded and private label promotional activity, particularly with fruits, vegetables and tomatoes, as consumers react to economic conditions and respond to this increased retailer activity. We believe the resulting volume dislocations are short term and are -- and we are actively monitoring the situation. I'll discuss this in more detail when I address our business unit performance, but first, I wanted to provide a brief update on our accelerated growth strategy with its three strategic initiatives targeted to grow EPS over the coming years.

Our first strategic initiative is to use pricing actions and productivity savings to neutralize cost inflation. In Q3, pricing and productivity actions more than offset operational costs, which continued at levels higher on a year-over-year basis. We are on track to hit our pricing target of three times the level taken last year, as well as our productivity transformation savings target of \$50 million. We remain committed to neutralizing cost inflation and announced a March -- announced for March a 7.5% pricing increase in our dry dog food business. This is consistent with pricing that's been taken by the industry where we are price follower. This pricing action will combat costs that have continued to rise after our previous price increase.

As we have discussed, our pricing actions have been taken to reflect our higher costs, and combined with our productivity initiatives are successfully addressing some of the cumulative margin pressures impact of the inflationary cost increases that we have experienced over the past couple of years. As we assess our base pricing on shelf, we believe our products, both consumer and pet, continue to represent a very good value with superior quality and consistent quality for each of our segments.

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Going forward, we will also continue to aggressively pursue additional productivity initiatives. Ongoing cost reduction must be a key priority for us.

Our second initiative is to focus on growing our higher-margin core businesses by increased investment in their associated brands. This means that we will increase marketing spend and drive innovation of these core brands beyond business as usual. A great example of this is our recent launch of a new \$8 million national advertising campaign for our Pup-Peroni brand dog snacks. This first-ever national television campaign for Pup-Peroni features 15 and 30-second television spots and is targeted to aggressively build trial and repeat for this brand.

Our third objective is to drive our packaged produce at pet products growth engines with category building, innovation and marketing. These growth engines leverage our brands to fill unmet consumer and customer needs where there are attractive category and margin dynamics, as well as white space growth expansion opportunities. In consumer packaged produce we have Fruit Citrus bowls launched in Q1 and Super Fruit launched in Q2. With our pet businesses, we announced on Monday our spokes dog for Milkbone and this is celebrating our Milkbone 100-year anniversary. As we have previously outlined, to ensure successful execution of these key strategic initiatives, we needed to implement three support actions at the beginning of the fiscal year.

Two out of the three are completed; increasing the marketing-centric focus of our organization by centralizing marketing in San Francisco under a unified CMO leadership, and upgrading our portfolio with the divestiture of Starkist seafood. The third support action, increased marketing investment, is ongoing and is also tracking to plan, as we work to drive consistent long-term EPS growth. For fiscal '09, we continue to target a 30% plus increase in marketing investment year over year to support our plans to grow future earnings. Based on our Q3 and year-to-date results we continue to see positive momentum as a result of our investment, as we exit F '09 and enter fiscal '10. In sum, I believe that we're making good progress against our accelerated growth strategy and are pursuing the right steps to deliver consistent, positive EPS performance.

Turning back to Q3, Del Monte's strong top-line performance was largely driven by pricing actions and new products across both consumer and pet. With our pricing actions, we anticipated elasticity-driven volume declines and similar to Q2, this decline was largely consistent with those projections. Our Q3 EPS was \$0.30 compared to prior year of \$0.24. We're pleased that gross margins increased 280 basis points, reflecting pricing and cost reduction actions offsetting a 13% increase in year-over-year costs, recouping some of the margin contraction experienced over the past several years. Importantly, this gross margin improvement helps to ensure our ability to reinvest in the long-term health of our business. The 13% cost increase primarily reflects the higher year-over-year ingredient and raw product costs, similar to the first half. While many commodity and ingredient costs have declined from the historic highs reached earlier this fiscal year, overall these input costs remain elevated when compared to the prior few years.

I'd now like to run briefly through the consumer and pet business unit performance. Turning first to consumer, we're pleased with the performance of our consumer business, with net sales up 3% and operating income up 15%. Q3 net sales primarily reflect pricing actions with Del Monte, a category price leader in fruit and vegetables. Net sales also benefited from new products, particularly the College Inn, vegetable and Center Store fruit. The majority of the reduced volume that we experienced was due to pricing-related elasticity, which came in largely as expected. The remaining volume decline, primarily in vegetables and fruit, was driven by higher-than-forecasted competitive promotional activity. The price points reflected in this activity do not reflect the higher cost levels the industry has incurred and is therefore, we believe, not sustainable.

As a category leader, our Q3 promotional activity continued to reflect our pricing strategy and commitment to move category price points to levels that help offset cost increases. During Q3, Del Monte refrained from investing at lower promotional price levels at the expense of share to support our long-term objective of delivering a margin structure that can support category-growing innovation and marketing investments. As predicted, our Q3 share performance was impacted by our lower overall volumes, as well as the tough year-over-year comparisons with the F '08 third quarter, in which Del Monte promoted heavily. On a sequential basis, fiscal '09 quarterly shares are relatively stable. Going forward, we expect an upward migration in

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overall category pricing, reflecting higher costs that are being experienced by all players. We also anticipate branded and private label category shares to trend back to more normalized levels, as higher price points are reflected on the shelves.

The 15% increase in consumer operating income primarily reflects pricing actions, combined with productivity gains, exceeding cost increases as we focus to recoup some of the margin contraction that's occurred over the last few years. In regards to costs, we increased marketing investment in Q3 in packaged produce, our key consumer growth engine. Operating costs experienced year-over-year increases in Q3, primarily driven by raw products. We negotiate price contracts with growers typically once a year for these raw products, which include peaches, green beans, peas, table corn and tomatoes. This contrast to our pet business, where exchange-traded field corn, wheat and soybean meal are hedged, or purchased throughout the year. Now let me turn to our pet product business.

Similar to consumer products, we are also pleased with the performance of our pet business. Both top-line and operating income increased 15%. Our pet net sales reflect pricing actions and new products. We -- it also reflects strong Kibbles 'n Bits performance. We did experience a slight decrease in overall volume due to the elasticity of our price increases, which is also in line with our expectations. Our dry pet food business is extremely well positioned for the current environment and in the third quarter, benefited from consumer migration to mainstream brands, value channels and larger sizes. With Kibbles 'n Bits we have successfully worked to position the brand as offering premium taste at mainstream price. This effectively meets today's consumer trends, resulting in a very strong third quarter performance, particularly in non-grocery channels.

Meow Mix also continued its strong performance, driven by improved product positioning and increased share in non-grocery channels. In addition, 9Lives dry nutrition for the masses positioning resonated with consumers looking for premium nutrition at an attractive price. We believe that our dry pet food portfolio is uniquely positioned for continued growth behind a combination of motivating branding, distinct positioning, meaningful performance, and competitive pricing. In total, this delivers a very strong and sustainable value proposition. Our pet snack business saw no change in consumer treating habits when faced with the declining economic conditions. Pet parents are continuing to indulge their pets. Pup-Peroni and Milkbone showed strong consumption momentum, as both soft and chewy and the biscuit categories continued to show strong growth, with both categories up near double digits.

Additionally, our stable of products benefits from improved distribution and incremental merchandising, as well as strong seasonal consumption from people increasing pet treating during the key holiday season. Shares were stable, with slight decreases in grocery offset by gains in non-grocery, as consumers moved to value channels. The 15.5% increase in pet operating income reflects pricing and productivity savings ahead of cost increases. Cost increases were primarily from pet ingredient costs, particularly grains, meat byproducts and fats.

And with that, I'll turn the meeting over to Dave.

Dave Meyers - *Del Monte Foods Company - CFO*

Thanks, Rick. In Q3 EPS from continuing operations of \$0.30 is favorable relative to our expectations. Our EPS results reflect strong execution across key levers, coupled with the benefit of delayed timing of certain marketing activity to better match new product launches and lower operational costs. In Q3, net sales growth of 8.4% was strong. Looking at Q3 top-line drivers in greater detail, pricing increased net sales by 14.4 points, which was partially offset by 6.7 points of pricing-related volume elasticity. New products contributed 2.4 points, while existing product volume reduced net sales by 1.7 points. As discussed by Rick, we realized lower promotional volume in our vegetable and fruit businesses due to competitor promotional activity, as well as a tough year-over-year comparison. In Kibbles 'n Bits, however, we saw a strong dry pet volume behind solid execution.

Gross margin for the quarter was 30%, an increase of 280 basis points versus last year. Net pricing drove a 9.6-point increase. Higher commodity and ingredients costs, including grains, fats, oils and meats and other raw product increases drove a -6.6 points of margin contraction. As expected, we gained pricing momentum in Q3, as we realized the benefit from cumulative

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pricing actions aimed at regaining some of the margin contraction we experienced over the past few years. In addition, volume mix was relatively flat at -0.2 points. Q3 operating income increased 21%, with operating margins increasing 150 basis points. Operating income growth was driven by the \$46 million increase in gross profit, as margin growth reflected effective pricing coupled with strong top-line growth.

We also realized higher SG&A driven by strategic investments in marketing, as well as the absence of the prior-year \$10 million gain on the sale of the S&W trademark and absent of trades transformation expenses in the prior year. Interest expense in the quarter was \$7 million lower, driven by lower debt levels and lower interest rates. During the third quarter we spent \$16 million on capital projects versus \$21 million a year ago. Capital spending decreased year over year due to the absence of transformational investments in the year-ago period. We incurred \$25 million in depreciation and amortization costs, which includes \$1 million of fee amortization included in interest expense.

On a year-to-date basis, cash flow, operating less investing, was positive \$199 million versus a negative \$50 million a year ago. This increase in cash flow is driven by the sale of our seafood business. Excluding the impact of the seafood sale, adjusted cash flow on a year-to-date basis was negative \$111 million versus a negative \$50 million a year ago. The decrease in adjusted cash flow is primarily driven by higher inventory levels, primarily due to a larger vegetable and fruit pack in the consumer products business and higher input costs across the portfolio, which increases the value per case. We also have higher prepaid assets reflecting approximately \$30 million of additional commodity futures positions that we have taken for hedging purposes.

Now I'd like to discuss guidance for full-year fiscal 2009. We are increasing our expected EPS and continuing operations range to be \$0.64 to \$0.68 from the previous range of \$0.58 to \$0.62. We are also increasing our top-line growth to be 9% to 11% over prior year, which captures -- which compares to previous guidance of 8% to 10%. The increase in expected EPS primarily reflects lower operational costs, stronger top-line growth, and lower interest costs. Looking at cash flow, we are increasing our adjusted cash flow guidance to be the midpoint of \$150 million to \$170 million, an increase from the lower end of that range with both previous and current guidance excluding the impact of the Starkist divestiture. The slide illustrates additional key guidance metrics, including D&A and CapEx.

In looking at our cost buckets in greater detail, we are reducing our expected gross inflationary and other cost increases to be approximately \$290 million, \$10 million lower than the previous expectation of approximately \$300 million we discussed in our last conference call. The \$10 million change primarily reflects lower diesel prices, as well as lower other transportation costs. Looking at our \$290 million of cost increases in greater detail, you can see that the changes are not significant across any of our cost buckets other than logistics relative to our last estimate. I should also note that, as a result of our hedged positions and sudden pullback in commodities and energy, our third quarter EPS includes a \$0.02 mark-to-market loss. In Q3, we realized the benefit of our pricing, as pricing and productivity savings more than offset cost increases for the full portfolio. You can see this on this chart -- you can see on this chart our recently-announced price increases in our pet business.

Looking to Q4, we expect solid top-line growth across both consumer and pet. EPS is expected to benefit from our cumulative pricing actions, which will be ahead of cost pressure, as we recoup some of the margin contraction realized over the last few years. As discussed, we are expecting to significantly accelerate our marketing spending relative to prior-year's fourth quarter of fiscal 2008. Overall, we expect EPS to be slightly above prior-year's fourth quarter of \$0.23 EPS on a GAAP basis.

Many of you have asked for our perspective on F '10 guidance with the particular focus on the pullback in commodity costs. We will provide a complete picture of F '10 guidance during our next conference call in June. That said, we are cautiously optimistic about the overall health of our base business, as we look ahead into the next fiscal year. I would, however, like to touch on some cost issues we are seeing as we begin to look toward F '10. On the key hedgable commodity cost inputs, as a reminder, they represent approximately 15% of our \$2.8 billion operational cost base. While key commodities, such as diesel, natural gas, corn, and soybean meal have pulled back, we are also seeing indications of higher tin plate costs, which also represent approximately 15% of our operational cost base. In addition, we are experiencing higher meat costs in our pet business.

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We are also concerned about drought conditions in California, as rainfall totals were only approximately 70% to 75% of normal through mid-February, and most reservoirs are at only approximately 35% of capacity after two years of below-average precipitation. A key water source for the agricultural industry is the Sierra snow pack, which was estimated in mid February at approximately 60% to 70% of normal. We are managing the water situation in both fruit and tomatoes to assure supply for this season and expect to get our desired tonnage level of both fruit and tomatoes, so costs may end up higher.

With that, I'll turn it back to Rick.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you very much, Dave. And in conclusion I'd like to say that we're very pleased with the Company's quarterly performance, which reflects a Company-wide focus on our accelerated growth plan. The positioning of our brands, effective pricing and keeping costs in line have all enabled us to deliver this strong quarter. We also believe that we're very well positioned for future growth. Our strategy is working, the trends are in our favor and our categories are healthy.

Going forward, we will remain focused on driving our higher-margin core brands and key growth engines with strategic investments in marketing and innovation. Importantly, we will also redouble our efforts to continue to successfully reduce our costs and improve productivity by driving manufacturing and energy efficiencies, as well as continuing to improve our network optimization and sourcing savings. We are confident that combined, these efforts will drive long-term sustainable EPS growth for the Company and its shareholders. And with that, I'd like to thank you all for joining us and, of course, we'd now like to take all of your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from Reza Vahabzadeh with Barclays Capital. Please go ahead.

Reza Vahabzadeh - *Barclays Capital - Analyst*

Good morning.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Good morning, Reza, how are you?

Reza Vahabzadeh - *Barclays Capital - Analyst*

Good, thank you. Just on the last topic of the fruit packs, you've experienced ebbs and flows in the food pack in the past I'm sure many times. If the food pack ends up being somewhat short in a hypothetical scenario what are the options that you have deployed in the past to deal with that? Is it a cost issue, is it a volume issue? Can you somehow offset any headwind from that?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

What we do typically in those circumstances, Reza, is we will move volumes from lower-margin businesses to higher-margin businesses, so in many respects it results in a positive margin impact for the business and that is typically what we've done in

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the past. At this point, I'm not sure if we really would expect to have a real supply issue, but what we're indicating here are some of the risks that we may see in this coming year. But at this point the bloom is set, the bloom looks good, the chill nights have been adequate and those are all key precursors to a good yield. And as I say, we're concerned about water in the valley generally for both fruit and tomatoes and California's worried about it broadly. But for our fruit business, we should be okay in terms of total supply and the extent that we're short, we move it up the margin chain and should be fine.

Reza Vahabzadeh - *Barclays Capital - Analyst*

If I can just ask one follow up, how do you feel about inventory at retail and have you seen any inventory adjustments by retailers? Thanks much.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

We haven't in our business seen any inventory adjustment with our retailers. And in fact, I think one of the areas that we feel pretty good about is that we have been working really hard with our customers with our supply chain to reduce inventory across the entire system, ours and theirs. And actually we've had some recognition here in the last quarter -- very positive recognition as supplier of the year with a major customer that reflects the efforts that we have successfully made. As I've said earlier, we've taken 20 million miles out of our distribution system and that has been done in combination with careful, careful monitoring controls and systems that we've put in place to control our inventory and at this point, we feel good about the overall inventory levels that we have, our investors -- our customers have and we'll continue to try to make those more efficient.

Reza Vahabzadeh - *Barclays Capital - Analyst*

Thanks.

Larry Bodner - *Del Monte Foods Company - SVP - Finance, IR & Corporate Communications*

Thanks for your question, Reza. We should move on to the next caller.

Operator

Thank you. Our next caller comes from Farha Aslam from Stephens, Inc. Please go ahead.

Farha Aslam - *Stephens, Inc. - Analyst*

Good morning.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Hello, Farha, how are you?

Farha Aslam - *Stephens, Inc. - Analyst*

Congratulations on a very good quarter.

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Dave Meyers - *Del Monte Foods Company - CFO*

Thank you.

Farha Aslam - *Stephens, Inc. - Analyst*

You had talked about your commodity hedges, could you share with us where are you in those hedgable commodities?

Dave Meyers - *Del Monte Foods Company - CFO*

Yes, I think what we've said is we're about 90% to 95% hedged for fiscal F '09 and we will provide an update on the June call in terms of what our F '10 position is.

Farha Aslam - *Stephens, Inc. - Analyst*

Okay, and as one follow up, on your inventory positions as you had coming at the end of the fiscal third quarter, you were saying that they were higher than last year. How are those inventory positions relative to historical levels for fruit, veg and tomatoes?

Dave Meyers - *Del Monte Foods Company - CFO*

Yes, our fruit and vegetable inventory are higher than we anticipated. However, we feel good about our fourth quarter and we expect our inventories to come in pretty well balanced and our cash flow to come in as we projected.

Farha Aslam - *Stephens, Inc. - Analyst*

Okay, thank you.

Operator

Thank you. Our next question comes from Robert Moskow with Credit Suisse. Please go ahead.

Robert Moskow - *Credit Suisse - Analyst*

Thank you and congratulations, as well. I also think it's a good sign that you're continuing your marketing investment, 30% up from a year ago. I think that's a sign of health and commendable.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you, Rob.

Robert Moskow - *Credit Suisse - Analyst*

Let me ask you about pricing. If you were up three times the level you were in '08, how much spillover should we expect in fiscal '10 from these price efforts?

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Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Spillover, you mean in terms of additional pricing or you mean the ongoing benefit?

Robert Moskow - *Credit Suisse - Analyst*

Like the ongoing benefit, like just in terms of easy comparisons. Let's say you're done for the sake of argument, let's say you're done with pricing now on a list basis. Should we expect an easy overlap into fiscal '10?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Yes, we'll continue to see benefits of higher pricing as we go into fiscal '10. We have a chart that's on -- that's available to you on the presentation that shows the pricing and when we took it and that will better and more spec -- specifically indicate when the lapping will be occurring.

Robert Moskow - *Credit Suisse - Analyst*

Okay, so you're up 7.5% in the first half of '09 from a year ago, so does that mean that you'll be up -- well, it doesn't tell me how much pricing you're taking in the -- I guess it does. Second half you'll be up 7.5% for fiscal '09. Is that right?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Well, you can see on that -- Dave, I'll turn it over to you. You can see on that chart that the pricing increases we took in Q1 and Q2 of fiscal '09 and get a sense of the impact. I think the major pricing we took for veg and tomatoes was effective 8-1 of this fiscal year.

Robert Moskow - *Credit Suisse - Analyst*

All right.

Dave Meyers - *Del Monte Foods Company - CFO*

Yes, I think we will provide pricing guidance when we give our June -- on our June call we'll provide that guidance. But as Rick said, you can see the pricing effect that we've taken year to date and there will be a lapping effect in F '10. We'll provide that on our June call.

Robert Moskow - *Credit Suisse - Analyst*

All right.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

And we are focused very aggressively as a company on cost reduction programs and that's key for us and we've got a good history of that, Rob, and we plan to redouble our efforts there and that's going to be important for us going forward. Our target is 2% to 3% of costs and we'd rather see a three handle on it and so would all of our operating guys.

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Robert Moskow - *Credit Suisse - Analyst*

Do you care to reiterate the long-term growth model, are you still around 8% to 10% EPS?

Dave Meyers - *Del Monte Foods Company - CFO*

Yes, our long-term guidance is high single digits for EPS, mid single digits for NSP.

Robert Moskow - *Credit Suisse - Analyst*

Okay. Thank you.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you, Rob.

Operator

Thank you. Our next question comes from Tim Ramey with D.A. Davidson. Please go ahead.

Tim Ramey - *D.A. Davidson - Analyst*

Rick, I have to say, too, this was I think the best quarter you've pulled off this millennium, and note, too, that the quality of the quarter and the earnings seem quite high, so congratulations.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Tim, thank you for those comments. And there's nothing like a millennium achievement.

Tim Ramey - *D.A. Davidson - Analyst*

A couple of nitpicks to follow up on. Would you anticipate -- I don't think so, but would you anticipate any sort of buy-in or load occurring as a result of the dry dog food price increase that occurred?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

We would not at this point.

Tim Ramey - *D.A. Davidson - Analyst*

It would have occurred in the 3Q and you don't think it was in there?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

No.

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Tim Ramey - *D.A. Davidson - Analyst*

Yes, okay. And then also, I just have to ask about 6% net volume declines being in the range of expectations. That's still a fairly scary level of decline, understandable with a 14.4% increase in price.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Right.

Tim Ramey - *D.A. Davidson - Analyst*

What --

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Go ahead, Tim. I'm sorry.

Tim Ramey - *D.A. Davidson - Analyst*

Yes, I just -- why is that within the range of expectations?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Okay. Well, I think first, if we look at this on a year-to-date basis it provides a little bit of context. On a year-to-date basis, the overall Company is down about 1% and consumer for the first half was largely flat. So what you see in the third quarter is elasticity impact that reflects the pricing, but importantly also reflects the aggressive promotional activity that our competitors fielded for the holiday season. The price points that they -- at which they promoted we believe are price points that are below sustainable levels given the cost increases that they have incurred.

We believe our cost increases are actually probably less than the cost increases incurred by our competition, both private label and Green Giant, and that as a result the pricing in the overall category, promotional and regular, is going to have to move up to offset these costs. As a price -- as a price leader in the category, we are attempting to make sure that the health -- the categories are healthy enough to support innovation and marketing programs that drive volume, that drive these categories with our retailers. If our brand doesn't drive volume center store of these categories for our retailer, they will not have the volume that we hand drive without those programs. So we believe that, as we move our pricing up, that the categories will follow and that those prices reflect actual cost increases that we in the industry have incurred.

So it is not a number that we take lightly. We clearly are watching this very carefully. I think as I've said in the course of the last six months or so, this is the area that we need to watch very closely. We need to manage our way through it. We are comfortable with the elasticity levels at levels that we forecasted. We understand where these price points are from a promotional standpoint and we need to make sure that we've managed them carefully so we're not taking it lightly. As we do look at Q4 and going forward, we tend to see some positive momentum. We need to look carefully at our Easter promotion, but as we see things going forward they tend to be tracking where we expect them to go from a competitive category standpoint.

I would also -- this is an over-long answer, but I'd point out that the issues really are in our fruit and vegetable business, tomato volumes are essentially flat. And so we're looking -- and pet volumes are also essentially flat. So it's two categories and we need to really focus on those. We are, and it reflects the various factors I just went through.

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Larry Bodner - *Del Monte Foods Company - SVP - Finance, IR & Corporate Communications*

Tim. Thanks for your question. We should move on to the next caller.

Operator

Thank you. Our next question comes from Eric Katzman from Deutsche Bank. Please go ahead. Hi, good morning, everybody.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Morning, Eric.

Eric Katzman - *Deutsche Bank - Analyst*

I guess my follow up is, while it is a good quarter on its face, there's no question about that in the market like it sits today, it seems as if you basically made the decision to give up some share as your competition promoted aggressively. And I think in Dave's comments or slides there was also a push of the advertising and promotion from the third quarter into the fourth quarter, so it seems like you benefited from those two things, if I'm reading it correctly? And then my second question -- sorry, Larry, but my second question is, I don't understand how volume is down 6% and yet on a gross margin basis the volume mix component was barely changed, because that would seem to indicate greater productivity or maybe something else in terms of restructuring to take out capacity that I don't understand?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Okay. Well, first, in terms of your implications of share, you're right. We proactively decided to promote at levels that we believe are sustainable, long-term levels for the category and it worked with a portion of the market and a portion of the market went deeper than we promoted. We would expect, as I said, that those promotional price levels will tend to migrate up to fully reflect the costs that our competitors are seeing. And so we believe that that is a prudent move over the long term, but it's one that we need to look and watch and monitor very carefully and as I said, initial forecasts, as we look into 4 would give us reason to believe that those trends are okay and we'll talk about that in Q4. In terms of the advertising shift to Q4, why don't you go ahead, David?

Dave Meyers - *Del Monte Foods Company - CFO*

Yes, we did have some programs that were scheduled for the end of the third quarter that have moved to the fourth quarter, some Pup-Peroni advertising that we're very excited about, as well as some packaged produce advertising. We've also said that we will have a significant increase in our marketing spending in the fourth quarter, so we're comfortable with that flow. Additionally, the other key point in terms of the third quarter is we continue to have significant cost savings to the tune of about \$19 million in the third quarter (inaudible).

Eric Katzman - *Deutsche Bank - Analyst*

You were -- I'm sorry, you were breaking up there. Did you say \$19 million of cost savings?

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Dave Meyers - *Del Monte Foods Company - CFO*

Yes.

Eric Katzman - *Deutsche Bank - Analyst*

And that's the bridge between the volume decline on the top line and the fact that it barely hit gross margins?

Dave Meyers - *Del Monte Foods Company - CFO*

Yes, we had a very good mix in pet -- on our dry pet. We had a very good quarter, as Rick said, in Kibbles n' Bits, as well as snacks, and obviously, volume doesn't affect margin in terms of the margin calculation.

Eric Katzman - *Deutsche Bank - Analyst*

Right.

Dave Meyers - *Del Monte Foods Company - CFO*

It does effect absolute dollars.

Eric Katzman - *Deutsche Bank - Analyst*

Yes, but it doesn't seem like that was a big shift either way though.

Dave Meyers - *Del Monte Foods Company - CFO*

Not the volume mix, no.

Eric Katzman - *Deutsche Bank - Analyst*

Okay. Thank you.

Dave Meyers - *Del Monte Foods Company - CFO*

Thanks for your question.

Operator

Thank you. Our next question comes from Alton Stump with Longbow Research. Please go ahead.

Mario Montoya - *Longbow Research - Analyst*

Good morning, guys. This is actually Mario Montoya sitting in for Alton. Hey, guys, real quickly, just want to get a quick -- I don't know if you touched on it before, but a quick update on your 2000 cost guidance. During the last call you gave us a range of \$300 million COGS inflation. What is it looking for -- now that things have changed?

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Dave Meyers - *Del Monte Foods Company - CFO*

Yes, it's approximately \$290 million and there's an actual chart in the exhibits that we send out that you can see the makeup of the \$290 million.

Mario Montoya - *Longbow Research - Analyst*

Okay, perfect.

Larry Bodner - *Del Monte Foods Company - SVP - Finance, IR & Corporate Communications*

Thanks for your question. Next caller, please?

Operator

Thank you. Our next question comes from Ann Gurkin with Davenport. Please go ahead.

Ann Gurkin - *Davenport & Company - Analyst*

Good morning.

Dave Meyers - *Del Monte Foods Company - CFO*

Good morning, Ann.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Hello, Ann.

Ann Gurkin - *Davenport & Company - Analyst*

Just wanted to -- good morning. Just wanted to review again your priority uses of cash flow and also your comfort level, if that exists, to use your balance sheet for any kind of acquisitions if they should arise?

Dave Meyers - *Del Monte Foods Company - CFO*

We're comfortable with our cash flow projection. We said the midpoint of \$150 million to \$170 million. We've increased it a little bit based on our increase in EPS, and we will continue to focus on debt reduction, as we've said, for F '09. Again, acquisitions are opportunistic. We have very specific criteria that we look at when we look at an acquisition. However, again, for F '09, we're very focused on bringing our leverage down.

Ann Gurkin - *Davenport & Company - Analyst*

Okay. And then have you completed contract negotiations with farmers for your fruits and vegetables for 2010?

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Dave Meyers - *Del Monte Foods Company - CFO*

No, we have not. It's in process right now.

Ann Gurkin - *Davenport & Company - Analyst*

Okay, great. Thank you.

Dave Meyers - *Del Monte Foods Company - CFO*

Thank you.

Operator

Thank you. Our next question comes from Vincent Andrews with Morgan Stanley. Please go ahead.

Vincent Andrews - *Morgan Stanly - Analyst*

Thank you, and congratulations on a nice quarter.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you.

Vincent Andrews - *Morgan Stanly - Analyst*

I just wanted to follow up and ask about your confidence from a pricing perspective. In a couple of respects, one, that you're going to be able to hold your pricing given what's going on with the consumer, and everything we hear from retailers is they'd like to see pricing come down. And then, two, with the competitors' pricing why you're confident that that's going to go up beyond just you feel like it's not attractive from a margin perspective for them. At the same time, you're giving up significant share, which over the long run might be worth what the costs in the short run. Could you address those? Thank you.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you, Vince. This is a very bad connection and you also were cutting in and out, but I think I got some -- I think I got the majority of what you were saying. In terms of pricing, we believe that the price levels of our products in the market, A, reflect our costs, and as a result these are the costs of our products and our competitor products need to be sold at in order to have a sustainable margin. And so what gives us confidence is an historically strong competitive view about where the costs in the category -- where the costs in our fruit and vegetables, tomato businesses are we believe that we have some competitive benefits because of a variety of different reasons. So if anything, we believe our costs are equal to or possibly lower than the competition.

So looking at the cost issues we believe that the prices, both regular, as well as promoted, reflect a sustainable price point. We think our competitors will get there. In terms of the retailer, I think the retailers understand that. We have traditionally taken very careful pricing actions, which have always reflected true cost increases and that's a practice which we need and will continue to follow.

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In terms of promotional activity going forward, as I said, we need to make sure that we carefully monitor and interact with the consumer and with our customers. We have the ability to have more frequent promotional activity, which would certainly enable us to be more aggressive in the promotional front. We want to make sure that we maintain price points that allow us to have a margin, that allows us to innovate and support programs for center store. As I said, if we don't drive traffic there will be reduced take from -- reduced rate of growth and performance from all these categories and so that's why we believe that the prices we have will hold.

We are very sensitive to our customers' issues. We will work with them as best we can, as we always have, to make sure that the reality of the costs of these products reflect what their needs are with their customers and we believe that at the end of the day, that will result in price levels that reflect the economics of particularly the consumer business today.

Vincent Andrews - *Morgan Stanly - Analyst*

And do you -- just as a follow up, do you expect volume to be up in the fourth quarter and going into fiscal 2010?

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Yes, we anticipate -- as we mentioned, we see positive momentum going into the fourth quarter and we see that momentum carrying forward into -- positive forward carrying into F '10. And as a res -- and further on to a question that was asked earlier, I think it's important -- from our view it's clear that Q3 was not any unique movement of shares or advertising expense or investment or lack of investment, it really did reflect the business conditions as we see them in the quarter and we believe that those are leading to strong business conditions in Q4 and the guidance change that we provided.

Vincent Andrews - *Morgan Stanly - Analyst*

Okay. Thank you very much and again, congratulations.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you.

Operator

Thank you. Our last question comes from Robert Moskow with Credit Suisse. Please go ahead.

Robert Moskow - *Credit Suisse - Analyst*

Maybe it's too early to ask these questions, but can you give us for fiscal '10 kind of a heads up on pension expense? And then also advertising, do you think you need another investment year for advertising for fiscal '10 or are you at the level you want to be at now?

Dave Meyers - *Del Monte Foods Company - CFO*

We've stated at that. From a pension expense perspective, we anticipate the expense or EPS to be increased by approximately \$0.03 and we've also said that the actual cash flow will probably see an increase by approximately \$20 million, that was consistent with what we said last time. We haven't seen any dramatic changes, but we will give an update on our June call as to exactly

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what we see from a pension perspective. We've also said consistently that we do expect to step up marketing again in F '10 and on our June call we'll give specifics as to what that increase will be.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Rob, I think that that marketing investment reflects what we believe is a significant benefit that we've realized this year, with the consolidation of marketing here in San Francisco and with the -- unifying both our pet and consumer business under a single leadership structure with our Chief Marketing Officer, Bill Pierce and the teamwork that he and Nils are putting together to drive that part of our Company with operations and marketing and the strategy that looks beyond just the quarter. So we believe that the marketing spending that we are incurring is a lot more efficient given the benefits that we've realized with the consolidation of our marketing efforts and centralization of our marketing efforts here in San Francisco.

Robert Moskow - *Credit Suisse - Analyst*

Okay, thank you.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you, Rob.

Dave Meyers - *Del Monte Foods Company - CFO*

Thank you.

Larry Bodner - *Del Monte Foods Company - SVP - Finance, IR & Corporate Communications*

I think that wraps up the calling segment. We appreciate you tuning in to discuss the quarter with us and we look forward to talking with you in the future.

Rick Wolford - *Del Monte Foods Company - Chairman & CEO*

Thank you all very much for attending, talk to you soon. Bye.

Operator

Thank you. That does conclude today's conference call. You may disconnect at this time.

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