

November 27, 2006

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Food

## Hormel Foods Corp

**Rating: Buy**

**Price Target: \$45.00**

**Estimate Bias: Up**

**Risk Rank: Low**

**HRL: Raising Ests. and Price Target; Reiterate Buy Rating**

### Estimate and Price Target Change

#### Summary

- Following last week's 4Q06 earnings results, we are reaffirming our FY07 EPS estimate of \$2.21, initiating a FY08 EPS estimate of \$2.43 and raising our 12-month price target from \$39 to \$45.
- 4Q06 results were in line with the company's preannouncement on November 10 and well ahead of our original expectations. Sales for the quarter were \$1.56 billion, up 5.4% year over year, and EPS were \$0.64 versus \$0.59 last year.
- The better-than-expected results were driven by a strong performance from the Specialty Foods business (sales up 18% YoY) although results were solid in almost every division. We were particularly impressed by the operating margin of the Jennie-O Turkey business, which stayed at a double-digit level (11.6%) despite product shortages.
- HRL did reiterate its FY07 EPS guidance of \$2.15-\$2.25. In light of the recent rise in corn prices (up 60% over the past few months) we remain particularly encouraged by the guidance, but we also view it as prudently conservative.
- Corn prices will have a limited impact on the pork business due to the terms of HRL's contracts (based on cut-out value instead of raising costs) but will negatively impact the turkey business. HRL expects price increases on both pork and turkey to offset the corn impact, but 1Q07 results will likely see some margin pressure.
- Hormel also announced the acquisition of Saag's Products, a maker of premium sausage and smoked meats for \$18 million and a joint venture with San Miguel Corp, a hog producer in Vietnam for \$20 million. We expect the company to put its cash to work in FY07 through small deals or share repurchases.
- In our opinion, comparing HRL's 4Q results to the results of other protein players further demonstrates the strength of the company's business model. We continue to rate the shares of HRL a Buy.

Fundamentals		FY1 - Oct		2005	2006A		2007E	
Price (Nov 26, 2006)	\$37.99	EPS	Actual		Old	New	Old	New
52-Week Range	\$38.60-\$31.93	1Q	\$0.46A	\$0.50A	\$0.50A		\$0.49E	\$0.55E
Mkt. Cap. (mil.)	\$5,280.6	2Q	\$0.40A	\$0.48A	\$0.48A		\$0.53E	\$0.51E
Shares Out. (mil.)	139.0	3Q	\$0.37A	\$0.43A	\$0.43A		\$0.51E	\$0.45E
Float (mil.)	73.7	4Q	\$0.59A	\$0.64E	\$0.64A		\$0.69E	\$0.69E
Avg. Daily Trading Vol. (000)	260	Year	\$1.82A	\$2.05E	\$2.05A		\$2.21E	\$2.21E
Book Value/Share	\$12.97	P/E	20.9x		18.5x			17.2x
Dividend/Yield	\$0.60/1.6%	EV/EBITDA	9.6x		9.5x			8.5x
ROE	13.4%	Revenue (mil.)	\$5,414.0	\$5,759.3	\$5,745.5	\$6,094.2	\$6,029.6	
Cash & Equiv (mil.)	\$172.50	Operating Margin	7.8%	7.8%	7.8%	7.9%	8.2%	
Debt/Cap.	16.3%	Mean EPS	\$1.82	\$2.05	\$2.05	\$2.19	\$2.19	
Est. 5-Year EPS Growth	7%	Short Interest (000)		Estimate Changes			2006	2007
Convertible	No	10/06	547		05/25/06	\$2.01	\$2.21	
Major Index Membership		9/06	574		04/03/06	\$1.97	\$2.23	
		8/06	708		02/27/06	\$1.96	\$2.18	
		7/06	588		11/28/05	\$1.95	\$2.15	

## Comments

See comments above.

Figure 1: 4Q06 Results vs. 4Q05 and STRH Estimates

(\$ in millions, except per-share data)

	<u>4Q06A</u>	<u>4Q05A</u>	<u>YoY Change</u>	<u>4Q06E</u>
<b>Sales</b>				
Grocery Products	\$242.0	\$232.8	4.0%	\$263.1
Refrigerated Foods	770.6	739.5	4.2%	769.0
Jennie-O Turkey Store	316.0	311.3	1.5%	317.5
Specialty Foods	169.8	144.4	17.6%	158.8
All Other	58.8	50.0	17.7%	52.2
<b>Total Sales</b>	<b>\$1,557.3</b>	<b>\$1,477.9</b>	<b>5.4%</b>	<b>\$1,560.7</b>
<b>Gross Margin</b>	22.9%	22.2%	+70 bps	24.2%
<b>Segment Operating Margin</b>				
Grocery Products	19.3%	19.6%	-30 bps	19.9%
Refrigerated Foods	5.1%	5.2%	-10 bps	5.6%
Jennie-O Turkey Store	11.6%	13.3%	-170 bps	8.7%
Specialty Foods	8.9%	5.8%	-310 bps	8.0%
All Other	19.9%	17.3%	+260 bps	12.0%
<b>Total Operating Margin</b>	9.6%	9.7%	-10 bps	8.5%
<b>EPS</b>	<b>\$0.64</b>	<b>\$0.59</b>	<b>8.5%</b>	<b>\$0.60</b>

Source: Company Reports & STRH Estimates

\*4Q05 restated for FIFO adjustments

## Hormel Foods Corp.

### Income Statement

(dollars in millions, except per share data)

	2005	2006	2007E	2008E
Grocery Products	799.3	846.5	880.4	916.4
Refrigerated Foods	2,801.6	2,958.4	3,099.5	3,235.9
Jennie-O Turkey Store	1,088.3	1,105.5	1,122.3	1,152.7
Specialty Foods	518.7	624.6	697.5	760.2
All Others	206.1	210.6	230.0	248.3
<b>Net Sales</b>	<b>\$5,414.0</b>	<b>\$5,745.5</b>	<b>\$6,029.6</b>	<b>\$6,313.6</b>
% Change	13.3%	6.1%	4.9%	4.7%
Costs of goods of sold	4,131.4	4,362.3	4,580.8	4,783.2
Selling, Delivery and Marketing	691.8	754.1	789.3	823.9
Administrative & General	172.2	182.9	173.2	179.9
Equity in Earnings of Aff. (income)	(5.5)	(4.6)	(6.0)	(1.5)
Total Expenses	\$4,995.4	5,299.3	5,543.4	5,787.0
<b>Operating Income</b>	<b>424.1</b>	<b>450.7</b>	<b>492.2</b>	<b>528.1</b>
Interest and Investment Income	8.5	5.5	6.0	6.0
Interest Expense	(27.7)	(25.6)	(24.0)	(21.0)
Pretax Income	404.9	430.5	474.2	513.1
Income tax	151.4	144.4	168.3	182.1
Net Income before items	\$253.4	\$286.1	\$305.9	330.9
<b>Diluted Operating EPS</b>	<b>\$1.82</b>	<b>\$2.05</b>	<b>\$2.21</b>	<b>\$2.43</b>
Diluted Shares Outstanding	139.5	139.2	138.5	136.0
<b>EBITDA</b>	<b>\$568.1</b>	<b>\$571.8</b>	<b>\$640.2</b>	<b>\$678.1</b>
<b>Ratio Analysis</b>	<b>2005</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>
<b>Gross Margin</b>	<b>23.7%</b>	<b>24.1%</b>	<b>24.0%</b>	<b>24.2%</b>
Selling, Delivery and Marketing	12.8%	13.1%	13.1%	13.1%
Gen. & Admin.	3.2%	3.2%	2.9%	2.9%
EBITDA Margin	10.5%	10.0%	10.6%	10.7%
<b>Operating Margin</b>	<b>7.8%</b>	<b>7.8%</b>	<b>8.2%</b>	<b>8.4%</b>
Tax Rate	37.4%	33.5%	35.5%	35.5%
Net Margin	4.7%	5.0%	5.1%	5.2%
<b>% Change</b>	<b>2005</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>
Sales	13.3%	6.1%	4.9%	4.7%
Grocery Products	5.4%	5.9%	4.0%	4.1%
Refrigerated Foods	21.8%	5.6%	4.8%	4.4%
Jennie-O Turkey Store	3.4%	1.6%	1.5%	2.7%
Specialty Foods	10.9%	20.4%	11.7%	9.0%
All Others	2.5%	2.2%	9.2%	8.0%
Operating Income	18.0%	6.3%	9.2%	7.3%
EPS	15.7%	12.8%	7.7%	10.2%

Source: Company reports and SunTrust Robinson Humphrey estimates  
See last page for footnotes.

## Price Target Discussion

HRL is currently trading at 15.6x our FY08 EPS estimate, in line with its food peer group average and a discount to its historical five-year P/E of roughly 16.5x. We believe HRL's multiple warrants a premium to the food group average due to HRL's strong brand portfolio and high profit margin. Additionally, we see HRL as one of the safer plays in the food sector due to its (1) balanced business model (2) reduced exposure to commodity costs and the avian flu and (3) its growth prospects in the health market (Valley Fresh acquisition, Natural Choice), which is the current marketplace trend. Balancing this with the company's strong corporate history and solid management, our price target is \$45, or 18x our FY08 estimate.

## Price Target Risks

**Commodity Markets** - With both the cost of inputs (pork, poultry, and feed grain) and the level of revenue tied so closely to the volatile commodity markets, much of Hormel's profitability depends on external factors. Hormel's earnings can be affected by the production cycle, regulations, and weather, among other factors.

**Food Safety** - While food companies have insurance for food safety tragedies, the damage to the reputation of a brand due to recalls, consumer illness and/or death could be devastating. We believe Hormel is giving adequate attention and capital to food safety, but it remains an investment risk for any food or beverage company.

## Company Description

Hormel Foods Corp. produces numerous food and meat products and markets them throughout the United States. Pork and turkey remain the major focus for Hormel; going forward the company is emphasizing the manufacturing of branded, packaged items versus pure commodity meats. The company divides itself into five main segments, Grocery Products (18% of sales), Refrigerated Foods (48%), Specialty Foods (8%), Jennie-O Turkey Store (22%), and Other (4%). Hormel is also growing its ethnic foods business, which markets a variety of Mexican, Asian, Mediterranean, and other foods. Hormel is based in Austin, Minnesota and employs 15,500 people.

## Analyst Certification

I, William Chappell, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

## Important Disclosures

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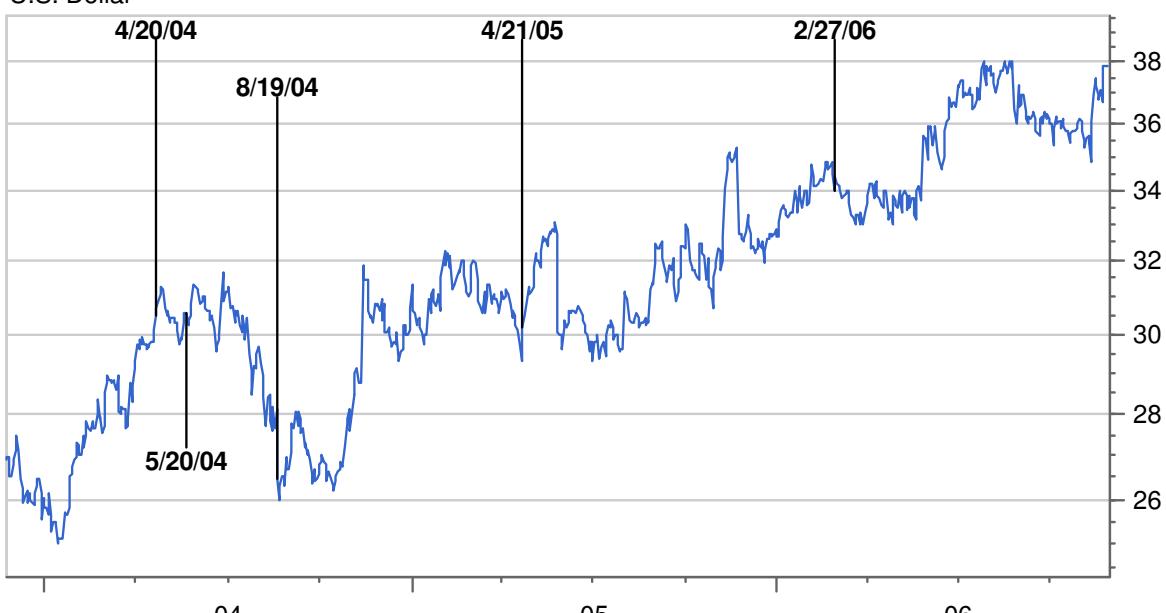
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## Hormel Foods Corp.

Nov 21, 2003 - Nov 24, 2006

U.S. Dollar



Data Source: Prices / ExshareSource: FactSet Research Systems

### Rating And Price Target History (HRL)

Date	Rating	Target	Closing
04/20/2004	Buy	\$33.00	\$30.50
05/20/2004		\$36.00	\$30.57
08/19/2004	Neutral	NA	\$28.14
04/21/2005	Buy	\$36.00	\$30.17
11/23/2005	Buy	NA	\$35.02
02/27/2006		\$39.00	\$34.00

On February 27, 2004, STRH implemented its current rating system (defined below). On that date we also reinstated the use of price targets that had been discontinued on December 3, 2002.

### Definition of Ratings

SunTrust Robinson Humphrey assigns one of three ratings to stocks covered by our Research Department: **Buy, Neutral, Reduce.**

In addition, we assign a risk rank to each stock based on a combination of fundamental and stock volatility factors:  
**Low** = Low stock price volatility reflected by high predictability of financial results.

**Moderate** = Moderate stock price volatility reflected by medium predictability of financial results.

**High** = High stock price volatility reflected by inconsistent predictability of financial results.

**Speculative** = Greatest stock price volatility reflected by low predictability of financial results.

**Venture** = Recommended only for maximum risk oriented and well-diversified portfolios.

Our ratings are a function of the risk ranking (higher return expectations for higher risk) and the absolute expected total return (price appreciation plus dividends) that result in our estimated 12-month price target. Please refer to the grid below for additional detail.

<b>Performance Definition Scale</b>				
Total return (capital gain/loss + dividends) expected over the next 12 months				
<b>Rating</b>	<b>Low Risk</b>	<b>Moderate Risk</b>	<b>High Risk</b>	<b>Speculative</b>
Buy	Over 10%	Over 15%	Over 20%	Over 25%
Neutral	-5% to 10%	-5% to 15%	-5% to 20%	-5% to 25%
Reduce	-5% or Worse	-5% or Worse	-10% or Worse	-10% or Worse

Deviations from expected price ranges/targets due to price movement and/or volatility will be reviewed by the analyst and research management on a timely basis. Price targets are only required on Buy rated stocks; The analyst may choose to have price targets on Neutral or Reduce rated stocks, but it is not required. Action taken by an investor should be based upon their personal investment objectives and risk tolerance compared to a stock's expected performance and risk ranking.

**Estimate Bias:** While current annual estimates are our best judgment at this time, we assign an "Up", "Neutral" or "Down" bias based on our expectation for fundamental changes over the next 12 months.

#### **SunTrust Robinson Humphrey ratings distribution as of 11/27/2006:**

<b>Coverage Universe</b>			<b>Investment Banking Clients Past 12 months</b>		
<b>Rating</b>	<b>Count</b>	<b>Percent</b>	<b>Rating</b>	<b>Count</b>	<b>Percent*</b>
Buy	154	50%	Buy	31	20%
Neutral	142	47%	Neutral	20	14%
Sell/Reduce	9	3%	Sell/Reduce	0	0%

\*Percentage of Investment Banking clients in Coverage Universe by rating

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