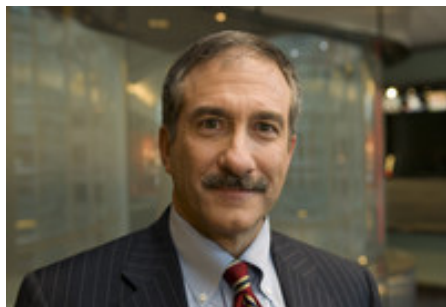


Dollar Dinners From ConAgra Threatened by Costs

By Tom Mulier and Matthew Boyle



Gary Rodkin, chief executive officer of ConAgra Foods Inc. Photographer: Jonathan Fickies/Bloomberg

August 19 (Bloomberg) -- The one-dollar dinner from ConAgra Foods Inc., a staple for Americans throughout the recession, is under threat from rising commodity costs.

ConAgra, which gets almost 3 percent of sales from products such as Zesty Smothered Meat Patty Banquet dinners, will have to raise prices or skimp on ingredients to maintain margins, said James Amoroso, a food industry consultant. That will provide an opportunity for Nestle SA, which has lost share to the Omaha, Nebraska-based company, analysts said.



Nestle, the maker of Hot Pockets and Lean Cuisine, is fighting to boost sales in the budget-meal market as growth lagged the company's average for the past two years. Photographer: Daniel Acker/Bloomberg

"It becomes a straightjacket because a \$1 meal can't be sold for \$1.20," said Amoroso, who is based in Walchwil, Switzerland. "The only way that manufacturers can cope with that is to significantly cheapen the offering. But if you say it's spaghetti bolognese and you're just selling red spaghetti, consumers will notice."

Nestle, the maker of Hot Pockets and Lean Cuisine, is fighting to boost sales in the frozen meals market as growth trailed the company's average for the past two years. ConAgra's cheaper prices limit the amount Nestle can raise prices on products including Stouffer's Corner Bistro Chicken Alfredo Flatbread melt, said James Targett, an analyst at Consumer Equity Research in London. Nestle would benefit if higher commodity prices make \$1 entrées untenable, he said.

"Anything which reduces the gap between the cheapest brand and your brand is a good thing," said Targett. A Stouffer's meal sells for an average price of \$2.56, according to SymphonyIRI Group, a Chicago-based market-research company.

ConAgra fell 38 cents to \$21.74 at 4:01 p.m. in New York Stock Exchange composite trading. Nestle fell 20 centimes to 53 Swiss francs in Zurich.

Primary Ingredients

Nestle had more than seven times the revenue of ConAgra in the companies' most recent fiscal years.

The last time commodity prices surged, ConAgra introduced a new line of the single-serve Banquet meals with an average price to \$1.50. Consumers ditched the brand, ConAgra's sales stagnated and the stock dropped more than a third between April and December of 2008. Chief Executive Officer Gary Rodkin relaunched Banquet in late 2008 and cut three of the meals that were more expensive to make, removing slow-cooked beef.

ConAgra is not planning any changes to the \$1 Banquet meals due to rising raw ingredient costs, brand director Christiane Brocky said in an interview. Banquet's primary ingredient costs are for beef, chicken and vegetables.

'Hard to Afford'

"We have built a business model to sustain that price point while delivering profit margins acceptable to ConAgra," she said. The company guards against price spikes through hedging and other measures including reducing transportation costs.

"It will get hard to afford the \$1 price point -- that is clear," said Christopher Growe, an analyst at Stifel Nicolaus & Co. in St. Louis who has a "hold" rating on ConAgra. One way to cope with higher commodity costs is to use less meat, he said. "But beyond that, I don't know what they can do."

Low-priced food like ConAgra's Spaghetti & Popcorn Chicken frozen dinners is the first place where higher agricultural commodity prices will hurt food companies' margins because there is less room for cost-cutting, Amoroso said. Food companies including ConAgra, Nestle, Unilever and Sara Lee Corp., which enjoyed a period of lower commodity costs in the first half of 2010, have warned of increased prices ahead.

Wheat Prices

Nestle can more easily afford higher costs than ConAgra. The company, the world's biggest foodmaker, has an operating margin more than 2 percentage points higher than ConAgra's and is coming into \$28.1 billion in cash this quarter from selling a stake in Alcon Inc.

The frozen-meal category "declined in 2009 and is projected to do so again in 2010," said Roz O'Hearn, a spokeswoman for Nestle's U.S. prepared foods business. "Deflation is present in the retail grocery world; companies are reducing prices on their products to retain consumers who have grown very value-conscious."

Nestle, which says its Lean Cuisine brands outsell ConAgra's Healthy Choice and H.J. Heinz Co.'s Weight Watchers by more than two to one, will continue to introduce new products and support them with "significantly" higher levels of advertising. The price of wheat has advanced 21 percent this year in Chicago trading while beef has gotten 14 percent more expensive and pork 39 percent.

Inflation Forecast

ConAgra has forecast cost inflation for the current fiscal year of 4 percent, with the biggest increases being expenses for procuring energy and protein for food. ConAgra's costs of goods sold will rise as much as 10 percent in future quarters, Sanford C. Bernstein estimates.

ConAgra has been selling \$1 meals since 1980 under the Banquet brand, which was originally launched in 1953. The actual prices range from 88 cents to \$1.05, depending on the meal and the retailer, spokeswoman Becky Niiya said. About half of Banquet's \$1 billion in sales come from single-serve frozen entrees that sell for around \$1 in supermarkets and Wal-Mart Stores Inc.

Winning Share

U.S. sales of Banquet's frozen entrees increased 5.7 percent to \$278 million in the year through July 11 while Stouffer's sales declined 6.6 percent to \$409 million, according to SymphonyIRI. The data excludes revenue from Wal-Mart Stores Inc.

"A sustained period of higher inflation could lead to the need to raise prices, or in the case of Banquet and other low-cost items, make ingredient substitutions," said Judi

Malter Rossetti, an analyst at Fitch Ratings. "Any price increase for Banquet would need to be minimal in order to retain its loyal customer base."

Food companies are likely to sacrifice profit margins to protect market share, said Bill Lapp, president of the consulting firm Advanced Economic Solutions in Omaha, Nebraska and the former chief economist at ConAgra. "You don't want to overreact," Lapp said in an interview. "If you make a mistake and lose market share, it might take two or three years to regain that."

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Aug 19, 2010 10:08 PM GMT+0200

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