TreeHouse Foods, Inc.
Form 10-Q
August 14, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934**
For the Quarterly Period Ended June 30, 2006

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Transition Period from to

Commission File Number 001-32504
TreeHouse Foods, Inc.
(Exact name of the registrant as specified in its charter)

Delaware	**20-2311383**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

Two Westbrook Corporate Center
Suite 1070
Westchester, IL 60154
(708) 483-1300
(Address, including zip code, and telephone number, including area code of the registrant s principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o Noþ

As of August 8, 2006 there were 31,202,473 shares of Common Stock, par value $0.01 per share, outstanding.

Table of Contents

Table of Contents

Part I Financial Information

Item 1. Financial Statements

TREEHOUSE FOODS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	June 30, 2006	December 31, 2005
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 4	$ 8,001
Receivables, net	56,165	34,636
Inventories	195,417	114,562
Deferred income taxes	2,452	2,569
Prepaid expenses and other current assets	5,835	4,922
Assets of discontinued operations	1,970	1,970
Total current assets	261,843	166,660
Property, plant and equipment, net	214,501	117,438
Goodwill	402,043	293,374
Identifiable intangible and other assets	73,696	32,225
Total	$ 952,083	$ 609,697
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 94,918	$ 61,457
Current portion of long-term debt	248,797	321
Liabilities of discontinued operations	50	93
Total current liabilities	343,765	61,871
Long-term debt	9,163	6,144
Deferred income taxes	8,406	9,421
Other long-term liabilities	52,649	18,906
Commitments and contingencies (Note 12)		
Stockholders equity:		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, none issued		
Common stock, par value $.01 per share, 40,000,000 shares authorized, 31,202,473 and 31,087,773 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	312	311
Additional paid-in capital	526,822	516,071
Retained earnings (accumulated deficit)	13,245	(748)
Accumulated other comprehensive loss	(2,279)	(2,279)
Total stockholders equity	538,100	513,355

Total	$ 952,083	$ 609,697

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

TREEHOUSE FOODS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
	(Unaudited)		(Unudited)	
Net sales	$ 232,118	$ 185,008	$ 404,842	$ 351,383
Cost of sales	183,595	144,544	315,929	273,075
Gross profit	48,523	40,464	88,913	78,308
Operating expenses:				
Selling and distribution	18,847	16,675	32,897	30,780
General and administrative	14,797	5,662	28,566	9,239
Management fee paid to Dean Foods		1,470		2,940
Other operating expense, net		7,135		7,279
Amortization expense	845	414	1,309	828
Total operating expenses	34,489	31,356	62,772	51,066
Operating income	14,034	9,108	26,141	27,242
Other (income) expense:				
Interest expense, net	3,252	172	3,413	365
Other income, net		(5)		(66)
Total other (income) expense	3,252	167	3,413	299
Income from continuing operations before income taxes	10,782	8,941	22,728	26,943
Income taxes	4,182	7,404	8,722	14,024
Income from continuing operations	6,600	1,537	14,006	12,919
Loss from discontinued operations, net of tax	(6)	(256)	(13)	(595)
Net income	$ 6,594	$ 1,281	$ 13,993	$ 12,324
Weighted average common shares:				
Basic	31,145	30,801	31,121	30,801
Diluted	31,231	31,060	31,224	31,060
Basic earnings per common share:				
Income from continuing operations	$ .21	$ .05	$ .45	$ .42
Loss from discontinued operations, net of tax		(.01)		(.02)
Net income	$ .21	$ .04	$ .45	$ .40
Diluted earnings per common share:				
Income from continuing operations	$ .21	$ .05	$ .45	$ .42

Loss from discontinued operations, net of tax				(.01)				(.02)
Net income	$	.21	$	.04	$	.45	$	.40

See Notes to Condensed Consolidated Financial Statements.

TREEHOUSE FOODS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six Months Ended June 30	
	2006	**2005**
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 13,993	$ 12,324
Loss from discontinued operations	13	595
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,766	8,256
Stock-based compensation	9,238	
Loss on disposition of assets	225	12
Deferred income taxes	(1,490)	753
Changes in operating assets and liabilities, net of impact of acquisitions		
Receivables	(17,293)	(1,529)
Inventories	(5,220)	13,451
Prepaid expenses and other assets	1,404	(1,498)
Accounts payable and accrued expenses	29,101	9,152
Net cash provided by continuing operations	40,737	41,516
Net cash (used in) provided by discontinued operations	(56)	2,320
Net cash provided by operating activities	40,681	43,836
Cash flows from investing activities:		
Additions to property, plant and equipment	(4,387)	(7,736)
Cash outflows for acquisitions	(294,677)	
Proceeds from sale of fixed assets	107	4
Net cash used in continuing operations	(298,957)	(7,732)
Net cash used in discontinued operations		
Net cash used in investing activities	(298,957)	(7,732)
Cash flows from financing activities:		
Proceeds from issuance of debt	250,000	3,672
Payment of debt	(1,828)	(2,295)
Payments of deferred financing costs		(808)
Proceeds from stock option exercises	1,482	
Tax benefit from stock options exercised	625	
Net cash activity with Dean Foods		(34,542)
Net cash (used in) provided by continuing operations	250,279	(33,973)
Net cash (used in) provided by discontinued operations		
Net cash (used in) provided by financing activities	250,279	(33,973)
Increase (decrease) in cash and cash equivalents	(7,997)	2,131

Cash and cash equivalents, beginning of period	8,001	165
Cash and cash equivalents, end of period	$ 4	$ 2,296

See Notes to Condensed Consolidated Financial Statements.

TREEHOUSE FOODS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
As of and for the six months ended June 30, 2006
(Unaudited)

1. General

TreeHouse Foods, Inc. (TreeHouse) was formed on January 25, 2005 by Dean Foods Company (Dean Foods) in order to accomplish a spin-off to its shareholders of certain specialty businesses. Dean Foods transferred the assets and liabilities of its former Specialty Foods Group segment, in addition to the *Mocha Mix*®, *Second Nature*® and foodservice salad dressings businesses conducted by other businesses owned by Dean Foods, to TreeHouse. TreeHouse common stock held by Dean Foods was distributed to Dean Foods stockholders on a distribution ratio of one share of TreeHouse common stock for every five shares of Dean Foods common stock outstanding. The transfer of assets and liabilities and the distribution of shares (the Distribution) were completed on June 27, 2005 and TreeHouse commenced operations as an independent public company. Dean Foods has no continuing stock ownership in TreeHouse.

For periods prior to June 27, 2005, all of the historical assets, liabilities, sales, expenses, income, cash flows, products, businesses and activities of our business that we describe in this report as ours are in fact the historical assets, liabilities, sales, expenses, income, cash flows, products, businesses and activities of the businesses transferred to TreeHouse by Dean Foods. References in the accompanying Condensed Consolidated Financial Statements and in these Notes to TreeHouse we , our and us mean TreeHouse. Our historical financial results as part of Dean Foods do not reflect what our financial results would have been had we been operated as a separate, independent company during the periods presented.

2. Significant Accounting Policies

Basis of Presentation The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2005. In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to present fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. As permitted, certain disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted. Our results of operations for the period ended June 30, 2006 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2005 Consolidated Financial Statements contained in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 29, 2006.

Use of Estimates The preparation of our Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires us to use our judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from these estimates under different assumptions or conditions.

Stock-Based Compensation (Post-Distribution) Effective July 1, 2005, we have adopted the requirements of SFAS 123(R) Share-Based Payment . This statement requires that compensation paid with equity instruments be measured at grant-date fair value and that the resulting expense be recognized over the relevant service period. Prior to the quarter beginning July 1, 2005, we elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees . As such, no compensation expense was recognized prior to the quarter beginning July 1, 2005 as stock options were granted at exercise prices that were at or above market value at the grant date.

Income Taxes Prior to the Distribution we were included in Dean Foods consolidated income tax returns and we did not file separate federal tax returns. Our income taxes were determined and recorded in our Consolidated Financial Statements as if we were filing a separate return for federal income tax purposes.

Recently Adopted Accounting Pronouncements In November 2004, the FASB issued SFAS No. 151, Inventory Costs an Amendment of ARB No. 43, Chapter 4. SFAS No. 151, which is effective for inventory costs incurred during years beginning after June 15, 2005, clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material, requiring that those items be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overheads be based on the normal capacity of the production facilities. The adoption of this accounting standard did not have a material impact on our Condensed Consolidated Financial Statements.

In December 2004, FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. SFAS No. 153 is effective for nonmonetary exchanges occurring in years beginning after June 15, 2005. SFAS No. 153 eliminates the rule in APB No. 29 which excluded from fair value measurement exchanges of similar productive assets. Instead SFAS No. 153 excludes from fair value measurement exchanges of nonmonetary assets that do not have commercial substance. The adoption of this accounting standard did not have a material impact on our Condensed Consolidated Financial Statements.

Table of Contents

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections . SFAS 154 replaces Accounting Principles Board Opinion No. 20 Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS 154 requires retrospective application of the direct effect of a voluntary change in accounting principle to prior periods financial statements where it is practicable to do so. SFAS 154 also redefines the term restatement to mean the correction of an error by revising previously issued financial statements. SFAS 154 is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005 unless adopted early. The adoption of this accounting standard did not have a material impact on the consolidated financial position, results of operations or cash flows, except to the extent that the statement subsequently requires retrospective application of a future item.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 . FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact this interpretation will have on our financial statements.

3. Discontinued Operations

On September 7, 2004, we announced our decision to exit our nutritional beverages business. Our decision to exit this line of business resulted from significant declines in volume, which we believed could not be replaced. In accordance with generally accepted accounting principles, our financial statements reflect our former nutritional beverages business as discontinued operations. The property and equipment was written down to its estimated fair value of $1.0 million and held for sale at June 30, 2006.

Net sales and income (loss) before taxes generated by our nutritional beverages business were as follows:

	Six Months Ended June 30	
	2006	2005
	(In thousands)	
Net sales	$ (6)	$ 99
Loss before tax	$ (21)	$ (951)

4. Facility Closing and Reorganization Costs

Facility Closing and Reorganization Costs We recorded facility closing costs of $1.0 million in the three months ended June 30, 2006 and $2.0 million in the six months ended June 30, 2006 related to the closing of the La Junta, Colorado pickle manufacturing facility and distribution center. In addition, the La Junta, Colorado property and equipment, which was written down to its estimated fair value of $1.6 million in the fourth quarter of 2005, was being held for sale as of June 30, 2006. Subsequently, on July 10, 2006 the distribution center was sold for $2.0 million.

Activity with respect to these liabilities for 2006 is summarized below:

	(In thousands)
Accrued charges at December 31, 2005	$ 434
Payments	(2,603)
Provision for the six months ended June 30, 2006	2,312
Accrued charges at June 30, 2006	$ 143

The accrued charges at June 30, 2006 are for employee severance and maintaining the closed facility in a saleable condition. Future costs related to the facility closing are expected to be $.6 million in 2006 and $.3 million in 2007.

5. Inventories

	June 30, 2006	December 31, 2005
	(In thousands)	
Raw materials and supplies	$ 47,537	$ 37,521
Finished goods	156,019	83,280
LIFO Reserve	(8,139)	(6,239)
Total	$ 195,417	$ 114,562

Table of Contents

Approximately $62.0 million and $88.8 million of our inventory was accounted for under the LIFO method of accounting at June 30, 2006 and December 31, 2005, respectively.

6. Intangible Assets

Changes in the carrying amount of goodwill for the six months ended June 30, 2006 are as follows:

	Pickles	Powder	Soup & Infant Feeding	Other	Total
			(In thousands)		
Balance at December 31, 2005	$ 34,031	$ 185,785	$	$ 73,558	$ 293,374
Goodwill from acquisition			108,669		108,669
Balance at June 30, 2006	$ 34,031	$ 185,785	$ 108,669	$ 73,558	$ 402,043

The gross carrying amount and accumulated amortization of our intangible assets other than goodwill as of June 30, 2006 and December 31, 2005 are as follows:

	June 30, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Net Accumulated Amortization	Carrying Amount
			(In thousands)			
Intangible assets with indefinite lives:						
Trademarks	$ 30,800	$	$ 30,800	$ 22,800	$	$ 22,800
Intangible assets with finite lives:						
Customer-related	44,722	(6,845)	37,877	11,846	(5,658)	6,188
Total	$ 75,522	$ (6,845)	$ 68,677	$ 34,646	$ (5,658)	$ 28,988

Intangible assets acquired in the six months ended June 30, 2006 are customer related intangibles acquired in the pickle segment in February 2006 and the trademarks, customer lists and transition services agreement with Del Monte Foods Company resulting from the acquisition of the soup and infant feeding business in April 2006. The trademarks are deemed to have indefinite useful lies because they are expected to generate cash flows indefinitely. Customer related intangibles are estimated to have a useful life of fifteen years and are being amortized over a fifteen year period on a straight line basis. Other intangibles relate to favorable terms on the transition services agreement with Del Monte Foods Company, which is being amortized on a straight line basis over the nine month term of the agreement. The company is in the process of finalizing the fair value and useful lives of these assets and as a result the amortization expense is subject to revision.

Amortization expense on intangible assets for the three months ended June 30, 2006 and 2005 was $845,000 and $414,000, respectively and $1.3 million and $828,000 in the six months ended June 30, 2006 and 2005 respectively. Estimated aggregate intangible asset amortization expense for the next five years is as follows:

2007	$3.8 million
2008	$3.7 million
2009	$3.5 million
2010	$3.5 million
2011	$2.2 million

7. Long-Term Debt

	June 30, 2006 Amount Outstanding	December 31, 2005 Amount Outstanding
	(In thousands)	
Revolving credit facility	$ 248,300	$
Capital lease obligations and other	9,660	6,465
	257,960	6,465
Less current portion	248,797	321
Total	$ 9,163	$ 6,144

Table of Contents

Revolving Credit Facility Effective June 27, 2005 we entered into a five-year unsecured revolving credit agreement with a group of participating financial institutions under which we can borrow up to $400 million. This agreement also includes a $75 million letter of credit sublimit, against which a $1.4 million letter of credit has been issued, but undrawn. We may request to increase the commitments under the credit facility up to an aggregate of $500 million upon the satisfaction of certain conditions. Proceeds from the credit facility may be used for working capital and general corporate purposes, including acquisition financing. The credit facility contains various financial and other restrictive covenants and requires that we maintain certain financial ratios, including a leverage and interest coverage ratio. We are in compliance with all applicable covenants as of June 30, 2006. We believe that, given our current cash position, our cash flow from operating activities and our available credit capacity, we can comply with the current terms of the credit facility and meet foreseeable financial requirements.

Interest is payable quarterly or at the end of the applicable interest period in arrears on any outstanding borrowings at a customary Eurodollar rate plus the applicable margin or at a customary base rate. The underlying rate is defined as either the rate offered in the inter-bank Eurodollar market or the higher of the prime lending rate of the administrative agent or federal funds rate plus 0.5%. The applicable margin for Eurodollar loans is based on our consolidated leverage ratio and ranges from 0.50% to 0.80%. In addition, a facility fee based on our consolidated leverage ratio and ranging from 0.125% to 0.20% is due quarterly on all commitments under the credit facility. Our average interest rate on debt outstanding at June 30, 2006 was 5.87%.

The credit facility contains limitations on liens, investments, the incurrence of subsidiary indebtedness, mergers, dispositions of assets, acquisitions, material lines of business and transactions with affiliates. The credit facility restricts certain payments, including dividends, and prohibits certain agreements restricting the ability of our subsidiaries to make certain payments or to guarantee our obligations under the credit facility. The credit facility contains standard default triggers, including without limitation:

- failure to pay principal, interest or other amounts due and payable under the credit facility and related loan documents;
- failure to maintain compliance with the financial and other covenants contained in the credit agreement;
- incorrect or misleading representations or warranties;
- default on certain of our other debt;
- the existence of bankruptcy or insolvency proceedings;
- insolvency;
- existence of certain material judgments;
- failure to maintain compliance with ERISA;
- the invalidity of certain provisions in any loan document; and
- a change of control.

Capital Lease Obligations and Other Capital lease obligations include various promissory notes for the purchase of property, plant and equipment and capital lease obligations. The various promissory notes payable provide for interest at varying rates and are payable in monthly installments of principal and interest until maturity, when the remaining principal balances are due. Capital lease obligations represent machinery and equipment financing obligations, which are payable in monthly installments of principal and interest and are collateralized by the related assets financed.

Receivables-Backed Facility Prior to the Distribution, we participated in Dean Foods receivables-backed facility. We sold our accounts receivable to a wholly-owned special purpose entity controlled by Dean Foods that is intended to be bankruptcy-remote. The special purpose entity transferred the receivables to third-party asset-backed commercial paper conduits sponsored by major financial institutions. Dean Foods treats the securitization as a borrowing for accounting purposes, and the assets and liabilities of the special purpose entity are fully reflected in our December 31, 2004 Consolidated Balance Sheet. The Dean foods receivables-backed facility bears interest at a variable rate based on the commercial paper yield, as defined in the agreement. Dean Foods did not allocate interest related to the receivables-backed facility to its segments. Therefore, no interest costs related to this facility have been reflected in our Consolidated Income Statements. Effective April 1, 2005, we ceased to participate in Dean Foods receivables-backed facility.

8. Stockholders Equity and Earnings per Share

Common stock distribution and issuance Our common stock was distributed to Dean Foods stockholders on June 27, 2005 in the ratio of one share of TreeHouse common stock for every five shares of Dean Foods outstanding as of the record date of June 20, 2005. As a result, Dean Foods distributed 30,287,925 shares of TreeHouse common stock to its shareholders. In conjunction with entering into employment agreements, TreeHouse management purchased approximately 1.67% of TreeHouse common stock directly from Dean Foods in January 2005. These shares are equivalent to 513,353 shares on a post-Distribution basis. As of June 30, 2006, there were 31,202,473 shares issued and outstanding. There is no treasury stock and there is no remaining stock ownership by Dean Foods.

Earnings per share Basic earnings per share is computed by dividing net income by the number of weighted average common shares outstanding during the reporting period. For all periods prior to June 30, 2005, basic earnings per share are computed using our shares outstanding as of the date of the completion of the Distribution. Diluted earnings per share incorporate the incremental shares issueable upon the assumed exercise of stock options. Certain of the Company s stock options were excluded from the calculation of diluted earnings per share because they were anti-dilutive, but these options could be dilutive in the future. The restricted stock and restricted stock unit awards are subject to market conditions for vesting which were not met as of June 30, 2006, so these awards are also excluded from the diluted earnings per share calculation.

Prior to completion of the Distribution, Dean Foods converted options on Dean Foods stock held by Dean s chairman and chief executive officer. These were converted on a pro-rata basis between options for Dean Foods and TreeHouse shares. As a result, there are 344,805 options outstanding as of June 30, 2006, which are exercisable at various prices. The new awards maintained both the pre-conversion aggregate intrinsic value of each award and the ratio of the exercise price per share to the market value per share. The net dilutive effect of these options are included in the diluted earnings per share calculation for all periods presented. During the quarter ended June 30, 2006, 114,700 options held by Dean s chairman and chief executive officer were exercised at a total price of $1.5 million.

The following table summarizes the effect of the share-based compensation awards on the weighted average number of shares outstanding used in calculating diluted earnings per share:

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
Weighted average shares outstanding	31,145,123	30,801,278	31,120,544	30,801,278
Assumed exercise of stock options (1)	86,092	259,133	103,547	259,133
Weighted average diluted common shares outstanding	31,231,215	31,060,411	31,224,091	31,060,411

(1) The assumed exercise of stock options excludes 1,705,802 options outstanding, which were anti-dilutive for the three and six months ended June 30, 2006 and 1,509,080

options
outstanding,
which were
anti-dilutive for
the three and six
months ended
June 30, 2005.

9. Stock-based Compensation

The following table summarizes stock option activity during the six months ended June 30, 2006. Options were granted under our long-term incentive plan and in certain cases pursuant to employment agreements. All options granted have three year terms which vest one-third on each of the first three anniversaries of the grant date.

	Employee Options	Director Options	Weighted Average Exercise Price
Outstanding, December 31, 2005	1,499,806	500,299	$ 26.27
Granted	360,740	45,000	$ 23.16
Forfeited	(117,498)		$ 29.30
Exercised		(114,700)	$ 12.92
Outstanding, June 30, 2006	1,743,048	430,599	$ 26.22
Exercisable at June 30, 2006	459,756	358,403	$ 24.15

During the six months ended June 30, 2006, the total intrinsic value of stock options exercised was approximately $1.5 million. No stock options were exercised in the first six months of 2005. The aggregate intrinsic value of outstanding and exercisable options was $3.4 million and $2.8 million, respectively, at June 30, 2006 and $11.8 million and $11.8 million, respectively, at June 30, 2005. The tax benefit recognized from stock option exercises in both the three and six month periods ended June 30, 2006 was $.6 million. Compensation cost related to unvested options totaled $11.4 million at June 30, 2006 and will be recognized over the remaining vesting period of the grants, which averages 2.1 years. The average grant date fair value of options granted in 2006 was $9.65.

In addition to stock options, in 2005 certain key management employees were granted restricted stock and restricted stock units pursuant to the terms of their employment agreements. TreeHouse issued 630,942 shares of restricted stock and 616,802 restricted stock units in the second quarter of 2005, of which 583,622 and 584,339, respectively, are outstanding as of June 30, 2006. Restricted stock generally vests one-third on each of January 27, 2006, 2007 and 2008. It is subject to a market condition that requires that the total shareholder return of TreeHouse exceed the median of a peer group of 22 companies for the applicable vesting period. In addition, there is a cumulative test at January 27, 2007 through 2010 that allows for vesting of previously unvested grants if the total shareholder return test is met on a cumulative basis. Restricted stock units have the same vesting dates as restricted stock, but they are subject to the condition that the price of TreeHouse stock exceeds $29.65 on each vesting date. The cumulative test extends for the two anniversary dates beyond the last vesting date of January 27, 2008. No restricted stock units or restricted shares were outstanding at June 30, 2006. Future compensation cost related to outstanding restricted stock units and shares of restricted stock totaled approximately $2.0 million and will be recognized over the next 2.75 years.

As stated in Note 2, for the quarter beginning July 1, 2005, we adopted the requirements of SFAS 123(R) Share Based Payments . The company elected to use the modified prospective application of SFAS 123(R) for these awards issued prior to July 1, 2005. Income from continuing operations before tax for the quarter and six months ended June 30, 2006 included share-based compensation expense for employee and director stock options, restricted stock and restricted stock units of $4.4 million and $9.2. million, respectively.

10. Employee Retirement and Postretirement Benefits

Pension, Profit Sharing and Postretirement Benefits Our employees and retirees participate in various pension, profit sharing and other postretirement benefit plans previously sponsored by Dean Foods. At the time of the Distribution, the obligations related to such plans were transferred to TreeHouse. Employee benefit plan obligations and expenses included in our Condensed Consolidated Financial Statements are determined based on plan assumptions, employee demographic data, claims and payments. In addition, as part of the acquisition of the soup and infant feeding business, we provide healthcare benefits to certain retirees who are covered under specific contracts. The net period benefit cost for the group was approximately $.7 million in the three months ended June 30, 2006.

Defined Benefit Plans The benefits under our defined benefit plans are based on years of service and employee compensation.

	Three Months Ended June 30		Six Months Ended June 30	
	2006	**2005**	**2006**	**2005**
	(In thousands)			
Components of net period cost:				
Service cost	$ 90	$ 80	$ 180	$ 160
Interest cost	360	399	720	798
Expected return on plan assets	(255)	(312)	(510)	(624)
Amortization of prior service costs	20	21	40	42
Amortization of unrecognized net loss	35	40	70	80
Effect of settlement		37		74
Net period benefit cost	$ 250	$ 265	$ 500	$ 530

We expect to contribute $3.2 million to the pension plans during 2006, of which $1.3 million has been paid as of June 30, 2006.

Postretirement Benefits We provide healthcare benefits to certain retirees who are covered under specific group contracts.

	Three Months Ended June 30	Six Months Ended June 30

	2006	2005	2006	2005
		(In thousands)		
Components of net period cost:				
Service and interest cost	$ 80	$ 73	$ 160	$ 146
Amortization of unrecognized net loss	25	16	50	32
Net period benefit cost	$ 105	$ 89	$ 210	$ 178

We expect to contribute $425,000 to the postretirement health plans during 2006, of which approximately $210,000 has been paid as of June 30, 2006.

Table of Contents

11. Acquisition

On April 24, 2006, we completed the acquisition of certain real estate, equipment, machinery, inventory, raw materials, intellectual property and other assets that are related to the Del Monte Foods Company (1) private label soup business, (2) infant feeding business conducted under the brand name Nature s Goodness®, and (3) the food service soup business (hereinafter collectively referred to as the Soup and Infant Feeding Business), and assumed certain liabilities to the extent related thereto. Immediately following the completion of the acquisition, the Soup and Infant Feeding Business became a division of our operating subsidiary, Bay Valley Foods, LLC. The acquisition of the soup and infant feeding business expands our offerings, primarily in the private label market allowing us to provide a broader line of goods to our customers. The value we expect to realize as a company is believed to exceed the amount paid to acquire the business.

The purchase price (subject to finalization of an adjustment for working capital) paid for the soup and infant feeding business by TreeHouse was $284.1, which includes acquisition related costs of $5.2 million. In addition TreeHouse assumed postretirement, vacation pay and lease, and other liabilities of $41.4 million. The acquisition was financed through $250 million of borrowings under our existing $400 million credit facility and available cash balances.

The acquisition is being accounted for under the purchase method of accounting and the results of operations are included in our financial statements from the date of acquisition. The purchase price was allocated to the net assets acquired based upon estimated fair market values at the date of acquisition. The purchase price allocations are preliminary because we have not finalized our estimate of the fair value of long-lived assets or intangible assets acquired. We have made a preliminary allocation to the net tangible and intangible assets acquired and liabilities assumed as follows:

		(In thousands)
Inventory	$	70,667
Property Plant and Equipment		102,402
Trade Name Natures Goodness		8,000
Customer Relationships		28,100
Transition Services Agreement		1,100
Goodwill		108,669
Other Assets		6,476
Total Assets Purchased		325,414
Assumed Liabilities		(41,360)
Total Purchase Price	$	284,054

We have hired a third party valuation firm to establish the fair value of the soup and infant feeding business inventory, real estate, machinery and equipment and the fair value of identifiable intangible assets. As a result of information obtained as we operate the business, values assigned to these assets could change. We are also assessing certain liabilities assumed in the transaction.

We have recorded intangible assets of $144.8 million during the three month period ended June 30, 2006, including $108.7 million of goodwill, $8.0 million of trademark indefinite lived intangibles and $28.1 million of customer and contract related definite lived intangibles. The weighted average useful life of the definite lived intangibles is fifteen years and $28.1 million of the intangible asset value is expected to be deductible for income tax purposes.

The Company has entered into a transition services agreement with Del Monte Foods Company whereby Del Monte will continue to provide various administrative and information technology support services until the soup and infant feeding business can be fully integrated into TreeHouse.

The following pro forma summary presents the effect of the soup and infant feeding business acquired during the second quarter of 2006 as though the business had been acquired as of January 1, 2005 and is based upon unaudited financial information of the acquired entity (in thousands, except per share data):

Table of Contents

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
	(In thousands)			
Revenue as reported	$ 232,118	$ 185,008	$ 404,842	$ 351,383
Revenue of purchased businesses for the period prior to acquisition	22,227	58,558	95,199	140,679
Pro forma revenue	$ 254,345	$ 243,566	$ 500,041	$ 492,062
Net income as reported	$ 6,594	$ 1,281	$ 13,993	$ 12,324
Net income of purchased businesses for the period prior to acquisition	5,120	1,895	10,903	11,209
Pro forma net income	$ 11,714	$ 3,176	$ 24,896	$ 23,533
Earnings per share basic				
As reported	$ 0.21	$ 0.04	$ 0.45	$ 0.40
Effect of purchased businesses for the period prior to acquisition	0.16	0.06	0.35	0.36
Pro forma earnings per share-basic	$ 0.37	$ 0.10	$ 0.80	$ 0.76
Earnings per share-diluted				
As reported	$ 0.21	$ 0.04	$ 0.45	$ 0.40
Effect of purchased businesses for the period prior to acquisition	0.16	0.06	0.35	0.36
Pro forma earnings per share-diluted	$ 0.37	$ 0.10	$ 0.80	$ 0.76

12. Commitments and Contingencies

Indemnification of Dean Foods We have an agreement with Dean Foods under which we have agreed to assume all contingent and undisclosed liabilities relating to our businesses or operations of our assets, including those incurred prior to the Distribution, and to indemnify Dean Foods for liabilities, other than certain tax liabilities, incurred by Dean Foods relating to the businesses or operations of our assets. In addition, under the tax sharing agreement, we will, with limited exceptions, be liable for all taxes attributable to our business that are required to be paid after the Distribution. We have agreed to indemnify Dean Foods for claims arising under the distribution agreement and the tax sharing agreement.

Tax Sharing Agreement We entered into a tax sharing agreement with Dean Foods which generally governs Dean Foods and our respective rights, responsibilities and obligations after the Distribution with respect to taxes attributable to our business.

Under the tax sharing agreement, we are also liable for taxes that may be incurred by Dean Foods that arise from the failure of the Distribution to qualify as a tax-free transaction under Section 355 of the Code (including as a result of Section 355(e) of the Code) if the failure to so qualify is attributable to actions, events, or transactions relating to the stock, assets, or business of us or any of our affiliates, or a breach of the relevant representations or covenants made by us in the tax sharing agreement or the Distribution agreement or to Wilmer Cutler Pickering Hale and Dorr LLP in connection with rendering its opinion. If the failure of the Distribution to qualify under Section 355 of the

Code is attributable to a breach of certain representations made by both us and Dean Foods or a change in law or change in the interpretation or application of any existing law after the execution of the tax sharing agreement, we will be liable for 50% of the taxes arising from the failure to so qualify.

Litigation, Investigations and Audits We are party from time to time to certain claims, litigation, audits and investigations. We believe that we have established adequate reserves to satisfy any probable liability we may have under all such claims, litigations, audits and investigations that are currently pending. In our opinion, the settlement of any such currently pending or threatened matter is not expected to have a material adverse impact on our financial position, annual results of operations or cash flows.

13. Supplemental Cash Flow Information

Cash payments for interest were $3.8 million and $.9 million for the six months ended June 30, 2006 and 2005, respectively. Cash payments for income taxes were $10.7 million and $0 for the six months ended June 30, 2006 and 2005, respectively.

14. Related Party Transactions

Management Fee Paid to Dean Foods Prior to the Distribution, Dean Foods provided us with certain administrative services such as tax, treasury, human resources, risk management, legal, information technology, internal audit, accounting and reporting in return for a management fee. The management fee was based on budgeted annual expenses for Dean Foods corporate headquarters and allocated among Dean Foods segments. We paid Dean Foods a management fee of $1.5 million and $2.9 million in the three months and six months ended June 30, 2005, respectively. No management fees have been paid to Dean post-Distribution.

Refrigerated Products Effective with the Distribution, we consolidated the Refrigerated Products manufacturing activities into a leased facility in City of Industry, California. For periods prior to the Distribution, product costs were charged to the Refrigerated Products businesses based on the direct materials, direct processing costs and allocated indirect labor, benefits and other processing and facility costs applicable to our products on a shared services basis. As a result, our Consolidated Statements of Income for periods prior to the Distribution reflect the fully absorbed costs for these products, along with allocated distribution, commission and administrative costs based on the volumes of products sold, including Refrigerated Products.

Agreements We have entered into a trademark license agreement, co-pack agreement and transition services agreement with Dean Foods. These agreements have not had a material impact on the operations of the company.

Sales to Dean Foods Sales to Dean Foods were not significant for the six months ended June 30, 2005.

15. Business and Geographic Information and Major Customers

Our pickles segment sells a variety of pickle, relish, sauerkraut and pepper products under customer brands and under our proprietary brands including *Farmans*®, *Nalley s*®, *Peter Piper*® and *Steinfeld* . Branded products are sold to retailers and private label products are sold to retailers, foodservice customers and in bulk to other food processors. The pickles segment also includes shrimp, seafood, tartar, horseradish, chili, sweet and sour sauces and syrups sold to retail grocers in the Eastern, Midwestern and Southeastern United States. These products are sold under the *Bennett s*®*, Hoffman House*® and *Roddenberry s*® *Northwoods*® brand names.

Our non-dairy powdered creamer segment includes private label powdered creamer and our proprietary *Cremora*® brand. The majority of our powdered products are sold under customer brands to retailers, distributors and in bulk to other food companies for use as ingredients in their products.

In addition to powdered coffee creamer, we also sell shortening powders and other high-fat powder formulas used in baking, beverage mixes, gravies and sauces.

Our soup and infant feeding business segment sells condensed and ready to serve soups, broths and gravies as well as infant baby cereals, fruits, vegetables, juices, meats, dinners and desserts. We sell our soups and gravies under private labels primarily to supermarkets and mass merchandisers. Infant feeding products are sold under the *Nature s Goodness*® brand and offer a complete product line focused on the four steps of a baby s development. The infant feeding products are sold to customers in grocery, and foodservice channels.

Our aseptic products and other refrigerated products do not qualify as a reportable segment and are included under other food products. Aseptic products are sterilized using a process which allows storage for prolonged periods without refrigeration. We manufacture aseptic cheese sauces and puddings. Our cheese sauces and puddings are sold primarily under private labels to distributors. Our refrigerated products include *Mocha Mix*®, a non-dairy liquid creamer, *Second Nature*®, a liquid egg substitute, and salad dressings sold in foodservice channels.

We have designated our reportable segments based on how management views our business and on differences in manufacturing processes between product categories. We do not segregate assets between segments for internal reporting. Therefore, asset-related information has been presented in total.

We evaluate the performance of our segments based on sales dollars, gross profit and adjusted gross margin (gross profit less freight out and commissions). The amounts in the following tables are obtained from reports used by our senior management team and do not include any allocated income taxes. There are no significant non-cash items reported in segment profit or loss other than depreciation and amortization. The accounting policies of our segments are the same as those described in the summary of significant accounting policies set forth in Note 2 to our 2005 Consolidated Financial Statements contained in our Annual Report on Form 10-K.

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
	(In thousands)			
Net sales to external customers:				
Pickles	$ 98,291	$ 94,798	$ 172,432	$ 168,001
Non-Dairy Powdered Creamer	60,775	61,289	127,613	125,838
Soup and Infant Feeding	42,659		42,659	
Other	30,393	28,921	62,138	57,544
Total	232,118	185,008	404,842	351,383
Operating income:				
Pickles	12,877	13,354	24,710	23,621
Non-Dairy Powdered Creamer	11,226	9,614	24,385	20,816
Soup and Infant Feeding	4,355		4,355	
Other	6,561	7,420	12,455	12,936
Segment adjusted gross margin	35,019	30,388	65,905	57,373
Other operating expenses	20,985	21,280	39,764	30,131
Operating income	$ 14,034	$ 9,108	$ 26,141	$ 27,242

Geographic Information During the six months ended June 30, 2006 and 2005, we had foreign sales of approximately 2.5% and 1% of consolidated net sales, respectively. We primarily export to South America and Canada.

Major Customers Our non-dairy powdered creamer segment and soup and infant feeding segment had one customer that represented greater than 10% of consolidated net sales during the first six months of 2006 and 2005. Approximately 14.4% and 11.5% of our consolidated net sales were to that customer. Our other food products segment had two customers that represented greater than 10% of our sales for the six months ended June 30, 2006 and 2005. Approximately 11.4% and 12.2% of our consolidated net sales were to those customers for 2006 and 2005, respectively.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations Business Overview

We believe we are the largest manufacturer of pickles and non-dairy powdered creamer in the United States based upon total sales volumes. We believe we are also the leading retail supplier of private label pickles, non-dairy powdered creamer and soup in the United States. We have three reportable segments of which the soup and infant feeding segment was added in the second quarter of 2006. We discuss the following segments in this Management s Discussion and Analysis of Financial Condition and Results of Operations: pickles, soup and infant feeding and non-dairy powdered creamer. We have designated our reportable segments based on how management views our business and on differences in manufacturing processes between product categories. The key performance indicators of our segments are sales dollars, gross profit and adjusted gross margin, which is gross profit less the cost of transporting products to customer locations (referred to in the tables below as freight out) and commissions paid to independent brokers.

Our current operations consist of the following:

Our pickles segment sells pickles, peppers, relishes and related products. We supply private label pickles to supermarkets and mass merchandisers across the United States. We also sell pickle products to foodservice customers, including relish and hamburger pickle slices. In addition, we sell pickle products under our own brands, including *Farmans*®, *Nalley s*®, *Peter Piper*® and *Steinfeld* that have a regional following in certain areas of the country. Our pickles segment also sells sauces and syrups to retail grocers in the Eastern, Midwestern and Southeastern United States under our proprietary *Bennett s*®, *Hoffman House*® and *Roddenberry s*® *Northwoods*® brand names

Our soup and infant feeding business segment sells condensed and ready to serve soups, broths and gravies as well as infant baby cereals, fruits, vegetables, juices, meats, dinners and desserts. We sell our soups and gravies under private labels primarily to supermarkets and mass merchandisers. Infant feeding products are sold under the *Nature s Goodness*® brand and offer a complete product line focused on the four steps of a baby s development. The infant feeding products are sold to customers in grocery, mass and foodservice channels.

Our non-dairy powdered creamer segment sells non-dairy powdered creamer under private labels and under our proprietary *Cremora*® brand. Product offerings in this segment include private label products packaged for retailers, such as supermarkets and mass merchandisers, foodservice products for use in coffee service and other industrial applications, including for repackaging in portion control packages and for use as an ingredient by other food manufacturers.

We also sell a variety of aseptic and refrigerated products. Aseptic products are processed under heat and pressure in a sterile production and packaging environment, creating a product that does not require refrigeration prior to use. We manufacture aseptic cheese sauces and puddings for sale primarily in the foodservice market. Our refrigerated products include *Mocha Mix*®, a non-dairy liquid creamer, *Second Nature*®, a liquid egg substitute, and salad dressings sold in foodservice channels.

Prior to 2005, we manufactured and sold aseptic nutritional beverages under co-pack arrangements and private labels. We exited the nutritional beverages business in the fourth quarter of 2004 due to significant declines in volume, which we believed could not be replaced without significant investments in capital and research and development. Our financial statements reflect the operations and assets related to the nutritional beverages business as discontinued operations.

We sell our products primarily to the retail grocery and foodservice markets.

Spin-Off from Dean Foods TreeHouse Foods, Inc. (TreeHouse) was formed on January 25, 2005 by Dean Foods Company (Dean Foods) in order to accomplish a spin-off to its shareholders of certain specialty businesses. Dean Foods transferred the assets and liabilities of its former Specialty Foods Group segment, in addition to the *Mocha Mix*®, *Second Nature*® and foodservice salad dressings businesses conducted by other businesses owned by Dean Foods to TreeHouse. TreeHouse common stock held by Dean Foods was distributed to Dean Foods stockholders on a distribution ratio of one share of TreeHouse common stock for every five shares of Dean Foods common stock outstanding. The transfer of assets and liabilities and the distribution of shares (the Distribution) were completed on June 27, 2005 and TreeHouse commenced operations as an independent public company. Dean Foods has no continuing stock ownership in us.

New York Stock Exchange Listing In conjunction with the Distribution, TreeHouse began regular trading on the New York Stock Exchange on June 28, 2005 under the symbol THS.

Recent Developments

Acquisition On March 1, 2006 the Company entered into an Asset Purchase Agreement with the Del Monte Foods Company to acquire the assets of its soup and infant feeding businesses for $284.1 million including an adjustment for working capital. The transaction closed on April 24, 2006. The acquisition was funded by drawing down approximately $250 million under the Company s $400 million unsecured revolving credit agreement and available cash. Management has performed a preliminary allocation of the purchase price, with $179.6 million allocated to tangible assets, $144.8 million allocated to intangible assets including goodwill, other assets of $1.1 million, and assumed liabilities of $41.4 million.

For the 12 months ended April 30, 2006, the private label soup and infant feeding businesses together generated approximately $295 million of net sales. Soup and infant feeding products are manufactured at facilities in Pittsburgh, PA and Mendota, IL. TreeHouse acquired the Pittsburgh, PA manufacturing facility and distribution center and entered into a long-term lease agreement at Del Monte s Mendota, IL manufacturing facility. The businesses headquarters will remain in Pittsburgh, PA.

The Company has entered into a Transition Services Agreement with Del Monte whereby Del Monte will continue to provide various administrative and information technology support services until the soup and infant feeding businesses can be fully integrated into TreeHouse.

Results of Operations

The following table presents certain information concerning our financial results, including information presented as a percentage of net sales.

	Three Months Ended June 30				Six Months Ended June 30			
	2006		2005		2006		2005	
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent
	(Dollars in thousands)							
Net sales	$ 232,118	100.0%	$ 185,008	100.0%	$ 404,842	100.0%	$ 351,383	100.0%
Cost of sales	183,595	79.1	144,544	78.1	315,929	78.0	273,075	77.7
Gross profit	48,523	20.9	40,464	21.9	88,913	22.0	78,308	22.3
Operating expenses:								
Selling and distribution	18,847	8.1	16,675	9.0	32,897	8.1	30,780	8.8
General and administrative	14,797	6.4	5,662	3.1	28,566	7.1	9,239	2.6
			1,470	.8			2,940	.8

Management fee paid to Dean Foods								
Other operating expense, net			7,135	3.9			7,279	2.1
Amortization expense	845	.4	414	.2	1,309	.3	828	.2
Total operating expenses	34,489	14.9	31,356	17.0	62,772	15.5	51,066	14.5
Total operating income	$ 14,034	6.0%	$ 9,108	4.9%	$ 26,141	6.5%	$ 27,242	7.8%

16

Table of Contents

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Net Sales Second quarter net sales increased approximately 25.5% to $232.1 million in 2006, compared to $185.0 million in the second quarter of 2005. Net sales by segment are shown in the table below.

	Net Sales			
	2006	2005	$ Increase/ (Decrease)	% Increase/ (Decrease)
	(Dollars in thousands)			
Pickles	$ 98,291	$ 94,798	$ 3,493	3.7%
Non-dairy powdered creamer	60,775	61,289	(514)	(.8)%
Soup and infant feeding	42,659		42,659	
Other	30,393	28,921	1,472	5.1%
Total	$ 232,118	$ 185,008	$ 47,110	25.5%

The increase in sales is largely due to the acquisition of the soup and infant feeding business in the second quarter. The increase in sales of the pickles segment in the second quarter of 2006 was mainly the result of the acquisition of the Oxford Foods pickle book of business in the first quarter of 2006 as well as price increases taken during the first quarter of 2006. Sales prices were raised in response to increases in the cost of raw materials, commodities, packaging and natural gas. Pickle sales in the second quarter increased 3.7% to $98.3 million in 2006 versus $94.8 million in 2005. Increases in foodservice pickles, due to the Oxford Foods acquisition, were partially offset by declines in retail private label and branded pickle sales. Non-dairy powdered creamer sales decreased slightly to $60.8 million in the second quarter compared to $61.3 million in 2005, as price increases taken in the first quarter of 2006 were offset by unit volumes declines in retail private label sales. Net sales of other products increased 5.1% to $30.4 million in the second quarter of 2006 from $28.9 million in the second quarter of the prior year primarily due to increased sales of refrigerated dips.

Cost of Sales All expenses incurred to bring a product to completion are included in cost of sales, such as raw material, ingredient and packaging costs; labor costs; facility and equipment costs, including costs to operate and maintain our warehouses; and costs associated with transporting our finished products from our manufacturing facilities to our own distribution centers. Cost of sales as a percentage of consolidated net sales increased to 79.1% in the second quarter of 2006 from 78.1% in the second quarter of 2005, primarily due to the acquisition of the soup and infant feeding business. Excluding the soup and infant feeding business cost of sales decreased from 78.1% in the second quarter of 2005 to 77.9% in the second quarter of 2006. Price increases taken in the first quarter of 2006 as well as cost reduction initiatives offset rising raw material costs, packaging and natural gas. We continue to experience increases in commodity costs such as corn syrup and sucrose compared to the second quarter of 2005. Our packaging costs increased in the second quarter due to higher energy costs which increased the cost of plastic containers and glass. See Results by Segment .

Operating Expenses Our operating expenses increased $3.1 million to $34.5 million during the second quarter of 2006, compared to $31.4 million for the second quarter of 2005. Selling and distribution expenses increased $2.2 million or 13.0% in the second quarter of 2006 compared to the second quarter of 2005 due mainly to the acquisition of the soup and infant feeding business. Excluding the soup and infant feeding expenses our selling and distribution expenses decreased $.7 million or 4.3% to $16.0 million. Despite higher fuel prices, which we estimate added approximately $.9 million to distribution costs in the second quarter of 2006 compared to the prior year s quarter, we were able to offset those increases with lower marketing expenditures and strategic initiatives that increased operating efficiencies and lowered our overall outbound freight costs. General and administrative expenses increased $9.1 million in the second quarter of 2006, primarily for the following reasons: (1) the adoption of SFAS 123(R), Share Based Payments, which increased operating expenses in the current quarter by $4.4 million, (2) hiring the TreeHouse management team and costs associated with becoming a publicly held company, which increased operating expense by $4.4 million from the prior year s quarter, (3) costs associated with closing the Lajunta, Colorado facility totaled $1.0 million in the quarter. In the second quarter of 2005, a $1.4 million management fee was paid to Dean Foods. No management fees were paid to Dean Foods in the current year s second quarter. Other operating expenses in the second quarter of 2005 recognized $2.3 million of income from the sale of our Cairo Georgia facility and the settlement of a high fructose corn syrup class action litigation, which were offset by $9.5 million of transaction expenses associated with the spin off of TreeHouse from Dean Foods.

Operating Income Operating income during the second quarter of 2006 was $14.0 million, an increase of $4.9 million, or 54.1%, from operating income of $9.1 million in the second quarter of 2005. Our operating margin was 6.0% in the second quarter of 2006 as compared to 4.9% in the prior year s quarter.

Income Taxes Income tax expense was recorded at an effective rate of 38.8% in the second quarter of 2006 compared to 82.8% in the prior year s quarter. The higher rate in 2005 was due to $9.5 million of Distribution expenses that were not deductible for income tax purposes. The effective tax rate in 2005 excluding this item was 38%. The higher effective rate in 2006 is primarily due to changes in the apportionment of income for state income tax purposes compared to previous estimates.

Table of Contents

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005 Results by Segment

Pickles

	Three Months Ended June 30			
	2006		2005	
	Dollars	Percent	Dollars	Percent
	(Dollars in thousands)			
Net sales	$ 98,291	100.0%	$ 94,798	100.0%
Cost of sales	78,802	80.2	75,146	79.3
Gross profit	19,489	19.8	19,652	20.7
Freight out and commissions	6,612	6.7	6,298	6.6
Adjusted gross margin	$ 12,877	13.1%	$ 13,354	14.1%

Net sales in the pickles segment increased by $3.5 million, or 3.7%, in the second quarter of 2006 compared to the second quarter of 2005. The change in net sales from the second quarter of 2005 to 2006 was due to the following:

	Dollars	Percent
	(Dollars in thousands)	
2005 Net sales	$ 94,798	
Volume	(6,690)	(7.0)%
Acquisitions	6,777	7.1
Pricing	3,406	3.6
2006 Net sales	$ 98,291	3.7%

The increase in net sales from 2005 to 2006 resulted primarily from the acquisition of the Oxford Foods foodservice business in the second quarter of 2006. Price increases were taken in all distribution channels during the first quarter of 2006 due to rising raw materials, packaging and natural gas. Sales volumes before the acquisition declined 7.0% in the quarter compared to a year ago primarily in the retail and foodservice (excluding Oxford