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Campbell Soup Co. (CPB)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Campbell Soup Second Quarter 2017 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will be given at that time. [Operator Instructions] And as a reminder, today's conference call is being recorded.

I'd now like to turn the conference over to Ken Gosnell, Vice President, Finance Strategy and Investor Relations. Please go ahead.

Kenneth Gosnell

Vice President-Finance Strategy & IR, Campbell Soup Co.

Thank you, Candice. Good morning, everyone. Welcome to the second quarter earnings call for Campbell Soup's fiscal 2018. With me here in New Jersey are Denise Morrison, President and CEO; and Anthony DiSilvestro, CFO.

As usual, we've created slides to accompany our earnings presentation. You will find the slides posted on our website this morning at investor.campbellsoupcompany.com. This call is open to the media, who'll participate in a listen-only mode.

Today, we will make forward-looking statements, which reflect our current expectations. These statements rely on assumptions and estimates, which could be inaccurate and are subject to risks. Please refer to slide 2 or our SEC filings for a list of factors that could cause our actual results to vary materially from those anticipated in forward-looking statements.

Because we use non-GAAP measures, we have provided a reconciliation of these measures to the most directly comparable GAAP measure, which is included in our appendix.

And one final item before we begin our discussion of the quarter, I'd like to cordially invite our interested shareholders, investors, members of the media, and consumers to listen to and view our investor presentation at CAGNY, which will be video webcast live on Wednesday, February 21, at 11:00 a.m. Eastern from Boca Raton. A replay of the video and copies of the materials will also be available afterward on our website. If you are attending the event, there will be a Campbell-sponsored lunch immediately after our presentation.

With that, let me turn it over to Denise.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Thank you, Ken. Good morning, everyone, and welcome to our second quarter conference call. Today, we'll discuss our results in the quarter and our updated outlook for the remainder of the fiscal year. I'll also detail the actions we're taking to improve our execution and performance in the second half of this year, while advancing the long-term transformation of Campbell in response to changing consumer and retailer dynamics.

This was a difficult quarter for the company. Our performance was below our expectations. Organic sales declined 2%, driven primarily by ongoing disappointing results in U.S. soup and Campbell Fresh. Adjusted EBIT

decreased 4%. I'll provide a brief overview now and additional details when I share my perspective on our segment performance in a moment.

Soup sales declined 7% in the quarter, modestly below what we expected. The issue with the key customer, which we last discussed with you in November, continued to negatively impact our U.S. soup sales this quarter. I'm encouraged that we're engaging in ongoing discussions with this key customer and making progress. The anticipated improvement in Campbell Fresh's performance did not materialize as we expected, with sales declining 1%. While we're making progress in addressing several execution issues, we faced new challenges in the quarter with headwinds in the super-premium juice segment.

Additionally, the carrot yield issue we discussed last quarter extended into the second quarter. The decline in adjusted EBIT reflected the performance of U.S. soup, cost of carrot increases in C-Fresh and significantly higher transportation and logistics costs, which are impacting all of our U.S. businesses. While we initially expected transportation costs to moderate throughout the year, the challenges have proved more persistent than originally anticipated, and we now expect it to continue to impact the business for the remainder of the year.

This morning, we updated our fiscal 2018 guidance, reflecting our outlook for the remainder of the fiscal year, the completion of the Pacific Foods acquisition, and the impact of the recently enacted tax reform legislation. We intend to use future proceeds from the lower tax rate to invest in innovation, particularly in health and well-being and snacking and to accelerate our e-commerce activities. Anthony will take you through the details of our updated guidance in a few minutes.

Finally, I want to touch on the status of our multi-year cost savings program. We continued to deliver meaningful savings and I'm pleased to say, we've identified additional opportunities that have enabled us to increase our savings target from \$450 million to \$500 million by the end of fiscal 2020.

Now, let's talk about our performance across our divisions; let's start with Americas Simple Meals and Beverages. Sales and operating earnings both declined in the quarter. The decline in the top-line was driven primarily by the performance of U.S. soup and V8 Beverages.

U.S. soup sales declined 7%, an improvement from the first quarter of the fiscal year, but still slightly below our expectations for this quarter. Nearly all of the decline was a result of the key customer issue referenced earlier. We've kept an open and positive dialogue with this customer and are making progress. I recognize that you likely have many questions about soup, but I know that you understand that we don't discuss details about specific customers. What I can tell you is that based on recent developments, we now expect sales declines in soup to moderate in the second half.

In the balance of the marketplace, we delivered better performance in soup as our program was well received and consumer takeaway was up slightly. In particular, the Well Yes! and Slow Kettle lines continued to perform well. We're pleased to have completed the acquisition of Pacific Foods in the quarter, and we're moving quickly to integrate the finance, supply-chain and quality functions. Pacific complements our portfolio by adding a differentiated brand with organic and functional attributes in soup, broth, and plant-based beverages that appeal to consumers seeking health and well-being benefits.

Turning to beverages; our V8 portfolio remained challenged and sales of V8 declined in the quarter. The shelf-stable beverage category continues to face headwinds. Despite the overall sales decline, we continued to see positive consumption trends in V8 +Energy. We're focused on reinvigorating the brand with innovation that

connects our vegetable nutrition equity with the functional benefits consumers are seeking, focusing on our profitable V8 Original and V8 +Energy lines.

Now, let's turn to Campbell Fresh. In the quarter, sales declined 1% and we recorded a loss of \$11 million. This performance was below our expectations. As I mentioned at the outset, the C-Fresh team has made progress in overcoming several of its operational challenges, namely, we've improved beverage and carrot quality, addressed capacity constraints in beverages, and returned the CPG business to competitive promotional levels.

However, our progress was slowed in the quarter by new challenges in the super-premium juice segment as we continued to experience higher carrot cost due to the yield issues we discussed last year.

Let's start with Beverages; the headwinds in the super-premium juice segment are multi-faceted. We believe the primary drivers are concerns about sugar and consumers migrating to functional beverages that deliver benefits such as protein, gut health, energy and hydration. Several customers recently reset their premium juice category, reducing space in the super-premium segment. Because of these resets and our previous supply constraints, Bolthouse Farms lost some shelf space, which hurt beverage sales in the quarter.

To address this, we're launching our most robust beverage innovation line in two years. Our upcoming beverage innovation suite is designed to address the sugar issue and evolve our beverage portfolio to be in step with consumer preferences. We believe it will begin to rejuvenate the super-premium segment by introducing functional benefits at an affordable price point, as well as expand our footprint in the ultra-premium segment.

We're launching 19 beverage SKUs this spring compared to just three a year ago. Notably, we just started shipping the new Bolthouse Farms B Line, which consists of eight varieties: B Strong and B Balanced delivers great taste, functional benefits and reduced sugar. B Strong is a protein drink with 70% less sugar than other leading brands, and B Balanced smoothies contains 50% less sugar than other brands. The B Line has been well received by customers as it meets the consumer preferences for reduced sugar and functional benefits.

Additionally, we're building on the initial success of our alternative dairy drink, Bolthouse Farms Plant Protein Milk, by expanding our plant-based offerings in the ultra-premium segment with three new protein varieties of 1915 by Bolthouse Farms. We expect our spring beverage innovations will drive improved performance in the second half.

Now an update on Farms; while sales of carrot and carrot ingredients increased 3% in the quarter, the yield issue we experienced earlier in the year extended into the second quarter. As we discussed in November, our carrot crops were negatively impacted by adverse weather, which resulted in extremely low yields and caused us to place customers on allocation. We came off allocation in December as planned, but the lingering effects of this issue drove higher carrot costs and impacted profit in the second quarter.

In the back half, our plans call for improved performance in Campbell Fresh. In support of our beverage innovation, we'll launch new marketing and promotional campaigns to improve CPG performance. We also remain focused on executing our quality strategy in carrots and delivering supply-chain productivity improvements.

At the highest level, we know that consumer preferences for fresh and healthier food continues to be strong, and we remain confident in the growth potential of the packaged fresh category. We're focused on improving our execution and returning C-Fresh to profitable growth.

Finally, our Global Biscuits and Snacks division; this division continues to deliver consistent performance, especially Pepperidge Farm. In the quarter, sales growth was primarily driven by the continued solid performance of Pepperidge Farm and gains in Kelsen in China.

In Pepperidge Farm, I'm pleased with the top-line performance of snacks, where both crackers and cookies contributed to gains and grew share in the quarter. Our cracker portfolio outpaced the category behind continued strong performance from the Goldfish brand. And in our cookie portfolio, the Farmhouse line, which delivers great taste with simple recognizable ingredients continued to perform well.

Outside the U.S., Kelsen delivered solid sales performance in China. I'm encouraged with the progress we've made in becoming a more consumer-focused operation and improving our logistics, supply-chain and the management of our expanded distribution network. This quarter, we had a strong sell-in for Chinese New Year and our distributors delivered well-executed merchandising programs leading up to the holiday, which is being celebrated today.

The division's operating earnings were impacted by rising inflation, particularly significantly higher prices for butter, which we're addressing through pricing actions and supply-chain productivity improvements.

Overall, I feel good about our performance in Global Biscuits and Snacks, and I'm confident that this team will continue to drive our core business, while integrating Snyder's-Lance into Campbell. We now expect to complete the Snyder's-Lance transaction by the end of the first calendar quarter.

In closing, this was a difficult quarter and I'm not satisfied with our performance. We're continuing to take actions to improve our execution and expect better results in the second half. We've made progress with our key customer around soup, and we now expect sales declines in soup to moderate in the second half.

We have plans in place to combat the headwinds in the super-premium beverage category segment and expand our presence in the ultra-premium segment of the market. We expect our robust beverage innovation and marketing to lead to improved performance in the back half for Campbell Fresh.

We're driving continued momentum in Global Biscuits and Snacks with strong performance in Pepperidge Farm. We're moving quickly to integrate Pacific Foods into Campbell. We're successfully executing our cost savings program and have identified new savings opportunities. And we're making the necessary investments to drive growth, including accelerating our e-commerce efforts with increased levels of activity and investing in long-term disruptive innovation.

Despite challenges in the quarter, we've made significant progress toward our long-term strategy to transform Campbell's portfolio in the faster-growing spaces of health and well-being and snacking. In particular, the pending Snyder's-Lance acquisition will be the largest acquisition in our history.

Snacking is a category we know extremely well and the acquisition complements Pepperidge Farm, which has been one of our best long-term performing businesses. We're confident that the Snyder's-Lance acquisition will deliver significant shareholder value. Campbell will look altogether different once we complete this transaction. The addition of Snyder's-Lance will have a transformational impact on Campbell, adding \$2.2 billion in annual net sales.

As a result, snacking will represent approximately 46% of our total company net sales. We're acting with urgency to transform Campbell. I'm confident that the steps we're taking will gain traction and lead to improved

performance. I look forward to answering your questions in a few moments and to seeing many of you at CAGNY next week, where we will share additional information on our strategic transformation.

But first, let me turn the call over to our Chief Financial Officer, Anthony DiSilvestro.

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

Thanks, Denise, and good morning.

Before getting into the details, I wanted to give you my perspective on the quarter and revised 2018 guidance. Our challenge in the quarter was our gross margin performance as the percentage declined by about two points compared to last year. Gross margin performance was pressured by cost inflation, primarily butter prices, as well as higher transportation and logistics costs, which did not moderate as expected and higher carrot and manufacturing costs in Campbell Fresh. Reflecting this performance and lower expectations going forward for C-Fresh, we recorded a non-cash impairment charge on the carrot and carrot ingredient business.

On the positive side, we continue to make progress on our multi-year cost savings program. We generated \$20 million of savings in the quarter, bringing the program to-date total to \$365 million. We now expect to deliver \$75 million to \$85 million in 2018. Based on our success to-date and additional opportunities identified, we have increased our 2020 target to \$500 million, a \$50 million increase.

We are benefiting from the recently enacted U.S. tax reform legislation. The lower, ongoing tax rate is benefiting Q2 EPS by \$0.12 and adding \$0.25 to the full-year adjusted EPS forecast as we lower our expected adjusted effective tax rate to approximately 26%. We are updating our full-year guidance to reflect lower expectations for gross margin performance on the base business, the addition of Pacific Foods to the portfolio, and the impact of U.S. tax reform.

Now, I'll review our results in more detail. For the second quarter, net sales on an as-reported basis were comparable to the prior year at \$2.180 billion. Excluding a one point benefit from the acquisition of Pacific Foods and a one point benefit from currency translation, organic net sales declined 2%, driven primarily by lower volumes in Americas Simple Meals and Beverages.

Adjusted EBIT in the quarter declined 4% to \$402 million, reflecting a lower adjusted gross margin percentage, partly offset by an increase in adjusted other income and lower marketing and selling expenses. Reflecting a lower adjusted effective tax rate attributable to tax reform, adjusted EPS increased 10%, or \$0.09 to \$1 per share.

For the first half, as-reported net sales declined 1% and organic net sales declined by 2% compared to the prior year. Adjusted EBIT decreased 10% to \$819 million, and adjusted EPS of \$1.91 was down 1%.

Breaking down our sales performance for the quarter; organic net sales declined 2%, driven by lower volume, reflecting declines in Americas Simple Meals and Beverages, driven primarily by U.S. soup and V8 Beverages. Overall, promotional spending rates were comparable to the prior year. There was a positive impact from currency translation of 1%, principally the Australian and Canadian dollar. There was also a 1% increase as a result of the recent Pacific Foods acquisition, which closed in December, bringing our as-reported sales to year-ago levels.

Our adjusted gross margin percentage decreased 220 basis points in the quarter. First, cost inflation and other factors had a negative impact of 330 basis points. The majority of this was cost inflation, which on a rate basis, increased about 3.5%, reflecting higher prices on dairy, meat, steel cans, and aluminum. The remainder was

driven by higher transportation and logistics costs, costs associated with our Real Food initiative, and higher carrot and manufacturing costs in Campbell Fresh. These negative drivers were partly offset by benefits from our cost savings initiatives.

Mix had a negative impact of 60 basis points, primarily due to the impact of the Pacific Foods acquisition, including the purchase accounting impact and negative mix from the sales decline in U.S. soup. Pricing had a positive impact of 20 basis points, driven by pricing on our Kelsen business as we partly recover significant cost increases on butter. Promotional spending also had a positive impact of 20 basis points in the quarter, primarily reflecting reductions of inefficient promotional spending on the Arnott's business.

Lastly, our supply-chain productivity program, which is incremental to our cost savings program, contributed 130 basis points of margin improvement. All in, our adjusted gross margin percentage decreased 220 basis points to 35.2%.

Marketing and selling expenses declined 5% in the quarter, reflecting lower advertising and consumer promotion expenses and the benefits from our cost savings initiatives, partly offset by investment in e-commerce. The majority of the reduction in advertising and consumer promotion spending reflects the timing shift on Kelsen from the second quarter into the third quarter to support the later timing of the Chinese New Year. Adjusted administrative expenses decreased 1% to \$139 million.

For additional perspective on our performance, this chart breaks down our adjusted EPS change between our operating performance and below-the-line item. Adjusted EPS increased \$0.09 from \$0.91 in the prior-year quarter to \$1 per share in the current quarter. On a currency-neutral basis, the decline in adjusted EBIT had a negative \$0.04 impact on EPS, primarily driven by our gross margin performance, partly offset by an increase in adjusted other income and lower marketing and selling expenses.

Net interest expense was up \$4 million, a \$0.01 negative impact to EPS, reflecting higher rates and an increase in the debt level associated with the acquisition of Pacific Foods. Our adjusted EPS results are benefiting from the ongoing benefit of U.S. tax reform. Our adjusted effective tax rate in the quarter, including a year-to-date true-up, declined by about 9 percentage points to 18.9%. The lower adjusted tax rate in the quarter increased EPS by \$0.11, including a \$0.12 per share impact from U.S. tax reform. Benefiting from share repurchases, the lower share count added a \$0.02 benefit to EPS. And lastly, although currency translation was slightly favorable, it had no impact on EPS, completing the bridge to \$1 per share.

Now turning to our segment results. In Americas Simple Meals and Beverages, organic sales declined 4%, driven primarily by declines in U.S. soup and V8 Beverages, partly offset by gains in our retail business in Canada. Excluding the benefit of the acquisition of Pacific Foods, sales of U.S. soup declined 7%, driven by declines in ready-to-serve and condensed soups. Broth sales were comparable to a year ago.

As previously discussed, U.S. soup sales were negatively impacted by reduced support levels with a key customer. As Denise mentioned, we are making progress and expect improved sales trends in the back half.

Dollar consumption of soup in measured channels declined by 3%. The difference between consumer takeaway and our sales is primarily due to higher retail sale prices. Changes in retailer inventory levels did not meaningfully impact our soup sales performance in the quarter.

Segment operating earnings decreased 9% in the quarter to \$282 million. The decrease was primarily driven by a lower gross margin percentage and lower sales volumes, partly offset by lower marketing and selling expenses.

Segment gross margin performance was impacted by higher transportation and logistics costs, as well as negative mix related to the acquisition of Pacific Foods and lower organic soup sales.

Here's a look at U.S. wet soup category performance and our share results as measured by IRI. For the 52-week period ending January 28, 2018, the category as a whole increased 80 basis points. Our sales in measured channels declined 1.2%. Including Pacific, on a pro forma basis, we had a 60% market share for the 52-week period, down 120 basis points from the year-ago period.

Private label grew share by 130 basis points, primarily reflecting gains in broth finishing at 14.9%. All other branded players collectively had a share of 25.1%, decreasing 10 basis points.

In Global Biscuits and Snacks, organic sales increased 3%, driven by gains in Pepperidge Farm snack, reflecting continued momentum in Goldfish crackers, and double-digit gains in cookies and also from gains on Kelsen cookies in China in advance of the Chinese New Year. Excluding the favorable impact of currency translation, sales of Arnott's biscuits were comparable to the prior year.

Segment operating earnings increased 1% to \$139 million. Excluding the favorable impact of currency translation, operating earnings were comparable to the prior year with lower advertising and consumer promotion expenses, offset by a lower gross margin percentage, reflecting higher levels of cost inflation, particularly on butter.

In the Campbell Fresh segment, organic sales declined 1% to \$257 million, driven primarily by sales decline in Bolthouse Farms' refrigerated beverages. Segment operating earnings in the quarter declined from a loss of \$3 million to a loss of \$11 million, reflecting a lower gross margin percentage, driven by higher supply-chain costs, as well as higher carrot costs attributable to adverse weather earlier in the fiscal year. Within this segment, the performance of the carrot and carrot ingredient business was below our expectations. We have lowered our future projections for the carrot business and in our reported results, recorded a non-cash impairment charge to reduce the carrying value of goodwill.

Cash from operations declined slightly to \$660 million, compared to \$667 million in 2017, as higher hedging-related payments were mostly offset by improved working capital performance. Capital expenditures were \$132 million, \$13 million higher than the prior year. We paid dividends totaling \$216 million, compared to \$207 million in 2017, reflecting the 12% increase in the quarterly dividend rate announced in September of fiscal 2017.

In aggregate, we repurchased \$86 million of shares on a year-to-date basis, \$75 million of which were under our strategic share repurchase program. The balance of repurchases were made to offset dilution from equity-based compensation. With the pending acquisition of Snyder's-Lance, we have now suspended our share repurchases. Net debt of \$3.7 billion is up from \$3.2 billion a year ago as the impact of the Pacific Foods acquisition debt was partly offset by positive cash flow on the base business.

Now, I'll review our revised 2018 guidance. As shown, we have isolated changes in our base business from the impact of the Pacific Foods acquisition and tax reform. We now expect sales to change by minus 1% to plus 1%. This includes a one point benefit from the Pacific Foods acquisition that was completed in December 2017. The sales outlook on the base business remains unchanged from our previous guidance.

Primarily due to lower expectations for gross margin performance, which I'll discuss in a moment, we now expect adjusted EBIT to decline by minus 7% to minus 5%, including a one point negative impact from Pacific Foods. As previously disclosed, we expect that the Pacific Foods acquisition will negatively impact EPS by \$0.05 in fiscal 2018.

We also expect the ongoing rate benefit of U.S. tax reform to have a positive impact on adjusted EPS of approximately \$0.25 in fiscal 2018, reflecting an adjusted tax rate of approximately 26%. All-in, we now expect adjusted EPS to increase by 2% to 4%.

As we'll discuss next week at CAGNY, we expect to utilize a portion, potentially a majority of the tax reform benefit to accelerate our investments in the P&L in fiscal 2019. In our next earnings call, we will update our guidance to include the impact of the Snyder's-Lance acquisition on the balance of our fiscal year.

Given the changes to our outlook, I'll wrap up with a recap of the key assumptions. We've seen an uptick in cost inflation and now forecast an inflation rate of approximately 3%. In addition, our supply-chain costs are being impacted by higher transportation and logistics costs and the increased carrot and manufacturing costs in C-Fresh, we continue to expect ongoing supply-chain productivity gains, excluding the benefit of our cost savings program of approximately 3% of cost of products sold. And against our cost savings program, we now expect to deliver \$75 million to \$85 million of cost savings, most of which will impact COPS. With higher-than-anticipated cost inflation and other supply-chain costs, as well as our expectation for a more normal soup promotional spending in the back half, and the acquisition of Pacific Foods, partly offset by increased cost savings, we expect our adjusted gross margins to decline about 1 percentage points.

Below the line, our interest expense is now expected to increase to a range of \$135 million to \$140 million, reflecting higher interest rates and increase debt to fund the acquisition of Pacific Foods. Reflecting the benefit of tax reform, we expect the adjusted effective tax rate to be approximately 26%. And because of the acquisition of Pacific Foods and the pending acquisition of Snyder's-Lance, share repurchases after completing \$86 million year-to-date are now on hold. This guidance assumes that the impact of currency translation will be slightly positive.

Lastly, we are forecasting capital expenditures of approximately \$425 million, which is an increase from the previous outlook, reflecting recently-initiated projects under our cost savings program and spending for Pacific Foods. That concludes my remarks.

Now, I'll turn it back to Ken for the Q&A.

Kenneth Gosnell

Vice President-Finance Strategy & IR, Campbell Soup Co.

Thanks, Anthony. We will now start our Q&A session. Since we have limited time, out of fairness to other callers, please ask only one question at a time. Okay, Candice?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Andrew Lazar – I'm sorry – our first question comes from Bryan Spillane of Bank of America. Your line is now open.

Bryan Spillane

Analyst, Bank of America Merrill Lynch

Q

Hey. Good morning, everyone.

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Good morning.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Good morning.

Bryan Spillane

Analyst, Bank of America Merrill Lynch

Q

Hi. So I guess, bigger question, you've got the tax savings which you're going to reinvest a portion of even into 2019, while at the same time there's – you're going through some cost savings. Can you kind of talk about sort of the incremental need to invest now? How much of that is driven by, like, the commodity inflation? How much of it is being driven by just how rapidly things are changing, I guess, in the retail environment? But it's a pretty material step-up in investment, and I'm just trying to understand sort of what changed to drive that investment?

And maybe, second, if you can give a little bit of comment on expected return? At what timeframe would we expect that that incremental investment will begin to kind of result in an acceleration in sales and earnings?

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Yeah. So I'll take a crack at that. As we look at our business and we're right in the middle of our planning process now for next fiscal year. And I think we've mentioned before the areas that we need to reinvest in along the lines of building capability in digital and e-commerce, supporting our brands and launching new products, investing in longer-term innovation, things like Habit and some other ventures that we have underway. And as we go through that and see the benefit of tax reform coming, we really do see an opportunity to accelerate those investments to position the company for long-term growth.

We're still working through some of the details on that and we'll have more to say, I think, when we get to our 2019 guidance. But we'll talk about this the next week. We really see 2019 as a transition year for us. We need to do a couple of things. We need to stabilize U.S. soup, we need to turn around our Campbell Fresh business, we need to make these investments to drive long-term growth, we need to add Pacific Foods and integrate Snyder's-Lance into the portfolio. And I think, as you look beyond 2019, our confidence level in achieving our long-term targets of 1% to 3% sales, 4% to 6% EBIT, and 5% to 7% EPS are very high. And I think that's where you'll start to see those returns.

Bryan Spillane

Analyst, Bank of America Merrill Lynch

All right. Thank you.

Q

Operator: Thank you. And our next question comes from Andrew Lazar of Barclays. Your line is now open.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Hi, good morning, everybody.

Q

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

Good morning, Andrew.

A

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Hi, Andrew.

A

Andrew Lazar

Analyst, Barclays Capital, Inc.

Hi. Denise, I know you're clearly limited in what you can say on sort of the soup situation as you mentioned, but maybe perhaps you can comment a little bit on sort of what is behind the expectation for a moderation in soup declines in the fiscal second half. I guess, what I'm getting at is, you had mentioned progress and I'm wondering if it can be, I guess, beneficial to all parties? I think Anthony had said may be a more normal promotional posture. So just trying to get a sense of what changes you can speak to and if it can be sort of, let's call it, mutual beneficial arrangement?

Q

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Yes. Well, as you know in the first half and particularly in this quarter, we did have U.S. soup sales declines. And if you look at our consumption, it was minus 3%, our sales were down 7%. The consumption in the rest of the market was positive. And so, the rest of the market, the soup programs actually were very well received.

As we go into the second half, given the positive conversations we've had, we expect a much more normal promotion schedule in the second half of the year and, therefore, our soup declines to moderate in the second half. And that's pretty much all I can say about it.

A

Andrew Lazar

Analyst, Barclays Capital, Inc.

Okay. No, I appreciate you laying out what you can. Thank you.

Q

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Thank you.

A

Operator: Thank you. And our next question comes from David Driscoll of Citi Research. Your line is now open.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hi, David.

David Cristopher Driscoll

Analyst, Citigroup Global Markets, Inc.

Q

Great, thank you and good morning. I literally have probably 10 questions, but I'll keep to your rule and just ask one. Andrew got the soup one, which is a great one. But C-Fresh, is profit recovery tied to sales growth? And then just explaining that a little further, what I'm trying to get at is, should we see profit recovery from these depressed levels even if sales are constant?

And then related to C-Fresh but on the sales line specifically, what is the second half expectation? It sounds like you're telling us that there should be a sizable boost with all the new product activity, but I'd really like to calibrate expectations well, the segment's been hard for us to forecast.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yeah, that's about five questions in one, but let me take a crack at it. What we have going on in the second half of the year is we have much more robust innovation in beverages, coupled with our supply constraints behind us and a normal promotional schedule. It's the first time that we've had all three legs of the stool going for us, and that's why we're optimistic that we can make significant gains in the beverage business in the back half of the year, and the rest of our CPG business in Campbell Fresh is positive growth. So getting beverages back to growth and continuing that momentum in the other parts of the business, and that's the higher margin part of the business is an important idea.

In carrots, carrots and carrot ingredients actually grew. However, because of the yield issue we had due to the adverse weather, it cost us more and, therefore, affected our profitability. Given that, we have very robust plans in the supply-chain and would improve productivity to make margin improvements in this business. And we are very, very focused on executing those.

So, the growth of the top-line in the CPG business, coupled with the improvement of margins from the supply-chain and productivity programs, should give us a much more profitable growth algorithm on this business.

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

But just to add to that, the margin recovery is not sales dependent and we would expect to see top-line growth and positive EBIT in Campbell Fresh in the second half of the year.

David Cristopher Driscoll

Analyst, Citigroup Global Markets, Inc.

Q

Thank you for the comments. I'll pass it along.

Operator: Thank you. And our next question comes from Ken Goldman of JPMorgan. Your line is now open.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Hi, Ken.

A

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Hi. Thank you. Hey, guys.

Q

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

Hi, Ken.

A

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Denise, I'm just curious, now that there's been a write-down taken, what about lessons that you learned from the Bolthouse acquisition? And is there anything that you can take, either positively or negatively, but hopefully constructively and applied to the Snyder's-Lance field that's obviously ahead? Or is it really just sort of a unique situation to Bolthouse where things didn't go quite as well as you thought when you first bought the business? At least that's how we look at on the outside.

Q

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Yeah, and that's a very constructive question. And there have been lessons learned from acquisitions, particularly that one. First of all, what we learned was that it's really an imperative to integrate supply-chain and quality earlier, in fact right out of the gate. Campbell has a very high standard as you know, and with what we went through in the Bolthouse Farms situation, we believe that, that's an imperative and we're doing that with Pacific as we speak. And we will do that with Snyder's-Lance after we close.

A

I think second of all, the carrot business was much more volatile than what we expected. This is fresh food and there's no roof over the factory of a carrot field. And so we're getting much better at recognizing what are the early warnings in that business, but that proved to be more volatile. There won't be any necessarily lessons learned from that because the Snyder's-Lance acquisition and the Pacific acquisition are in categories that we have a lot more experience in.

And then, I think, the third lesson is make sure you get the right people in the right place early. And so we're applying that philosophy going forward.

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Okay. That's very helpful. Just a quick follow-up. Obviously, Snyder's-Lance has its own DSD, Pepperidge has its own DSD. You talked about integrating the supply-chain right out of the gate. It doesn't require necessarily, how should I say this delicately, shutting down routes, that's not delicate but I tried. I'm just trying to figure out because there's some speculation out there that you will have to shut down or consolidate some route and that could be a little bit of an impediment to some of the goals that you have in that integration?

Q

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Yes, I can take that one. I would say, we have no plans to integrate the actual DSD systems, these are independent distributors, so we'll leave that at that. I think where we really see significant opportunity is we have overlapping warehouse systems, we have overlapping depots. And even before you get to the DSD guide, there's significant opportunity to extract cost synergies and that'll be our focus in the near term.

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

Operator: Thank you. And our next question comes from Rob Moskow of Credit Suisse. Your line is now open.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hi, Rob.

Robert Moskow

Analyst, Credit Suisse

Q

Hi, good morning.

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Hi, Rob.

Robert Moskow

Analyst, Credit Suisse

Q

I wanted to ask a broader question about beverages and Campbell's challenges and what you consider your competitive advantages in beverages. I mean, my perception is, a category like soup, the changes are more incremental and just relatively speaking, so Campbell can always compete. But beverages, I just find that this competitive environment is changing all the time.

You mentioned today that retailers are resetting their shelves away from sugar-enhanced items and refrigerated. You've had continued challenges in V8. Can you just comment a little bit about what you see your competitive advantages are in beverage? And whether – why does beverage belong with a food company and maybe not with another beverage company?

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Sure. I think it's really obvious when you look at consumer trends that there have been fundamental changes in consumer's preferences in the beverage category. Our competitive advantage in V8 is that we are vegetable-based. And in our 100% Vegetable Juice and in our V8 +Energy, which is powered by green tea, we actually have performed pretty well. It's where we've had the combination of fruit and vegetable, which is higher in sugar that we've been affected. And in the super-premium segment of the fresh business, we have now realized there is the same shift going on.

And that's why we've been very proactive in anticipating that shift and are able to launch a pretty extensive line of great tasting, reduced sugar with functional benefit beverages. And we've got more in the pipeline where that came from. So I feel really good that we're on top of the consumer trends, it's happening not only in juice, but it's happening throughout beverage world. And the beverage business is profitable for us and we consider it a good part of our portfolio.

Robert Moskow
Analyst, Credit Suisse

Q

Okay. Thank you.

Operator: Thank you. And our next question comes from David Palmer of RBC Capital Markets. Your line is now open.

Denise M. Morrison
President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hi, David.

David Palmer
Analyst, RBC Capital Markets LLC

Q

Thanks and...

Anthony P. DiSilvestro
Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Hi, David.

David Palmer
Analyst, RBC Capital Markets LLC

Q

...good morning. I just wanted to ask a question on soup, and I want to get away from the one customer thing, sometimes I feel like that keeps us from talking about the brand and the category fundamentals. But if you just include all of your customers in this answer, are there opportunities for improvement in your perspective in your U.S. soup pricing and promotion strategy, and perhaps things that you think about that will help the consistency of this business going forward, which will already be a smaller part of the business after Snyder's-Lance? Thanks.

Denise M. Morrison
President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yes. We spend a lot of time with our revenue management and working with our customers on the right pricing and promotion plans. In fact, we go into that, our joint business planning now through June with our key customers to work through that. We have to pay attention to the marketplace changes, and this category is price elastic. So that's an important thing to pay attention to. And there are some different dynamics depending upon whether you're working with condensed soup, RTS or broth. But all of that is taken into consideration as we plan our next season.

David Palmer
Analyst, RBC Capital Markets LLC

Q

Thank you.

Operator: Thank you. And our next question comes from Chris Growe of Stifel. Your line is now open.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

Hi, Chris.

A

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

Hi. Good morning.

Q

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

Hi, Chris.

A

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

Hi. I just had a question for you in relation to cost inflation and how you're addressing that from this point forward, particularly around freight and, obviously, things like butter. You mentioned in some cases, some price increases. So let me be a little bit more surgical, so is it relying on cost savings and productivity, or is it pricing and maybe perhaps lower promotional spending to accommodate cost inflation, is my question?

Q

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

Yeah. I would say we look at the latter, we look at it holistically. And I would say that over time, we expect our productivity improvement and price realization to more than offset cost inflation. Obviously, that can vary depending on the time period, and we're seeing some pretty high cost inflation right now. I mentioned 3.5% cost inflation rate in the quarter, significantly higher butter prices and that's primarily hitting our Kelsen business and the second quarter is their largest quarter of the year. So it is having a differential impact in the quarter. Kelsen has taken some pricing to recover part but not all, and we'll look for productivity improvement to help there as well.

A

On the transportation and logistics side, this is a volatile situation. Obviously, the rate increases are lasting longer than we expected. We don't know if this is a long-term phenomenon yet. But if it is, we would look to over time recover that through price realization as well. But we'll have to watch that one a bit closer.

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

Is this a year then, Anthony, where your pricing and your productivity combined, maybe it's more in the short-term, cannot overcome the cost inflation? And therefore, is that part of what the gross margin drag you estimate?

Q

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Yeah. So we see about a point of gross margin decline now. And I would say, probably about 60 basis points of that is the base business for the very reason you said, that we're not going to be able to cover cost inflation and these other supply-chain issues that we're experiencing, particularly around Campbell Fresh.

And the other, say, 40 basis points is the Pacific Foods acquisition, we bought it in December, so it's kind of off-season for them. And then when you add purchase accounting, so we've got this one-time step-up on inventory, we've got incremental depreciation and amortization, that's making the Pacific Foods dilutive to gross margin in fiscal 2018. But as we look ahead to 2019, we would expect Pacific to be modestly accretive at the EPS line. So, we've got a couple of things this year that I would consider, hopefully, more one-time in nature.

Christopher R. Gowe

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you for the color and we'll see you next week.

Operator: Thank you. And our next question comes from Jason English of Goldman Sachs. Your line is now open.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hi, Jason.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Hi, there. Thank you so much for let me ask you a question. I apologize in advance if I want to come back to soup with two questions. First, I'm not sure what it means that the back half of the year will be kind of a normal promotional environment, because you're kind of out of soup season. So there's not a whole lot of promotional environment in the back half of the year. Is it fair to interpret that as meaning when you go into the front half of next year, it's going to look more normal?

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

There actually is quite a bit of promotional activity through the third quarter. I would say, it starts to wane in the fourth quarter. And yes, we're anticipating that our promotional schedule will be more normal in the back half and in the first half of next year.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

That's helpful. And then my follow-on, the situation's really, really fascinating. At the core, it kind of looks like it's just been a big margin transfer, would you take in some pain in the form of volume deleverage and then take in some gain in the form of the price increases you mentioned at retail that aren't your own? Do you think that, that margin transfer is permanent? And what is the risk that that other retailers look to push for similar margin transfer?

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

I mean, the only way I can answer that is that again, we go through joint business planning with all of our customers, and we work through what our pricing and programs are going to be for the upcoming season. This is annual in addition to shelving and merchandising and that practice hasn't changed.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thank you.

Operator: Thank you. And our next question comes from John Baumgartner of Wells Fargo. Your line is now open.

John Joseph Baumgartner

Analyst, Wells Fargo Securities LLC

Q

Good morning. Thanks for the question.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hi, John.

John Joseph Baumgartner

Analyst, Wells Fargo Securities LLC

Q

Denise, just wanted to stick with soup and the investments there. I mean there's been a lot of change in the Simple Meals category over the past few years, whether it's been improved ingredients in the Frozen, traction from prepared, now there's meal delivery. So I guess, in light of the increased competition or I guess even fragmentation now, is it still reasonable to think that soup is kind of a mid-20% margin business going forward? I mean, why shouldn't we expect to see large reinvestments, whether it's directly into pricing or even in the integrated marketing spend, just given the evolution?

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

I mean, there's no question about the fact that there's different kinds of competition that are coming into the marketplace. And we've anticipated that competition. I mean, Well Yes! is a perfect example of where we co-created the brand with the consumer who was desiring a great tasting, clean label, recognizable ingredients soup. And we were able to put that out in the market and that brand has done very, very well.

I can also go to Slow Kettle, which fulfills the need for convenience, heartier, a little bit more premium dinner soup. And so I think that dynamic hasn't changed. If you listen to the consumer, there are still ways to satisfy that consumer as their preferences evolve in this category and do that at a good margin.

John Joseph Baumgartner

Analyst, Wells Fargo Securities LLC

Q

So, it sounds as though mix is still a lever you feel you can pull going forward, though?

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yes. Absolutely!

John Joseph Baumgartner

Analyst, Wells Fargo Securities LLC

Q

Great, thank you.

Operator: Thank you. And our next question comes from Jonathan Feeney of Consumer Edge. Your line is now open.

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hi, Jonathan.

Jonathan Feeney

Analyst, Consumer Edge Research LLC

Q

Hey, good morning.

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Hi, Jonathan.

Jonathan Feeney

Analyst, Consumer Edge Research LLC

Q

Hey, good morning. How are you? Thanks very much. And look forward to seeing you in Florida. Is there anything to read into the closing of the Snyder's-Lance deal on the next few weeks? I guess, I think your initial press release had said some time in calendar Q2, is there anything to read into that? And related to that, Anthony, your comment, I think it was to Ken's question that there are no intention to integrate the two independent business owner networks, I thought it was fascinating.

And maybe if you could delve into a little bit more to the extent you can, some of your follow-up commentary on the kinds of synergies and kinds of integration you're going to hope to achieve in that supply-chain, you've mentioned different warehouses and what not. I mean, if you're not putting those two things together, how exactly does putting those warehouse systems together work? Thanks very much.

Anthony P. DiSilvestro

Chief Financial Officer & Senior Vice President, Campbell Soup Co.

A

Sure. I guess, our expectations at the moment is that the Snyder's-Lance deal will close towards the end of the calendar first quarter. The only major hurdle left is shareholder approval of the Snyder's-Lance share owners. All the rest – all the more significant hurdles have been crossed. So hopefully, that will happen at that time. And we'll talk more about this next week. But we continue to see significant cost synergy opportunity between our Pepperidge Farm business and Snyder's-Lance, \$170 million of cost synergies and they run through a number of areas.

So but just commenting on the distribution side, Pepperidge Farm has a national warehouse system and a national depot system, hundreds of depots throughout the country. Snyder's-Lance has exactly the same thing. And this is even before the product gets to the independent distributor. So we see significant cost synergy opportunity in the distribution side of the business, we also see opportunity in procurement, we see supply-chain

opportunities, we see opportunities in a number of other areas. So we remain highly confident that we can get to the synergy targets that we've talked about with you before.

Operator: Thank you. And our next question comes from Michael Lavery of Piper Jaffray. Your line is now open.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Q

Thank you. Just back on soup. You talked about the strength that private labels had and its share gains. Can you talk about some of what's driving that? Is it primarily shelf-space and distribution gains? Is it an innovation push from private label? Is it just pricing driven? What are some of the factors there?

Denise M. Morrison

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yeah. Well, the way we're looking at it is private label grew share slightly in condensed and RTS, it grew share slightly but it's still below average and relatively small. Where private label has been more impactful has been in the broth business, and what we have done is recognize that we have a differentiated product with Swanson, and we need to talk more about our product differentiation and continue to differentiate that product.

In addition, the acquisition of Pacific Foods gives us a highly differentiated organic and functional broth product that we believe will set us up to satisfy different consumer needs.

Operator: Thank you. And that concludes our question-and-answer session for today. I'd like to turn the conference back over to Mr. Gosnell for any closing remarks.

Kenneth Gosnell

Vice President-Finance Strategy & IR, Campbell Soup Co.

Thanks, Candice. Thank you for joining our second quarter earnings call and webcast. A full replay will be available about two hours after our call concludes by going online or calling 1-404-537-3406, the access code is 6692659. You'll have until March the 2 at midnight at which point we move our earnings call strictly to the website, investor.campbellsoupcompany.com, under News & Events.

If you have further questions please call me at 856-342-6081. If you're a reporter with question, please call Tom Hushen at 856-342-5227. Thanks, everyone.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone have a great day.

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