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CPB - Q4 2015 Campbell Soup Co Earnings Call

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OVERVIEW:

Co. reported 4Q15 net sales as reported of $1.7b and adjusted EPS of $0.43. 2015 adjusted EPS was $2.46. Expects FY16 sales to grow 0-1% and adjusted EPS to be $2.53-2.58.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Campbell Soup fourth-quarter 2015 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. I will now turn the call over to your host, Ken Gosnell.

Ken Gosnell - *Campbell Soup Company - VP of Finance Strategy & IR*

Thank you, Stephanie. Good morning, everyone. Welcome to the fourth-quarter earnings call for Campbell Soup's FY15. With me here in New Jersey are Denise Morrison, President and CEO; Anthony DiSilvestro, CFO; and Blake MacMinn, Senior Manager of Investor Relations.

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 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 risk. Please refer to our 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.

Now I'd like to remind you about items impacting comparability. As we said in this morning's news release, in the fourth quarter the Company incurred charges associated with its initiatives to implement a new enterprise design that better aligns with our strategies to reduce costs and to streamline organizational structure. The Company recorded pre-tax restructuring charges of $93 million related to the program and pretax charges of $13 million in administrative expenses related to the implementation of these initiatives. The aggregate after-tax impact of the restructuring charges and implementation costs was $0.21 per share. Last year, in the fourth quarter of FY14, we recorded $21 million of pretax restructuring charges and restructuring related costs. We also recorded an additional $4 million of pretax settlement charges associated with the US pension plan. The aggregate after-tax impact of these items was $0.06 per share.

Also as a reminder, FY14 included 53 weeks, with the extra week falling in the fourth quarter. The extra week was worth an estimated $129 million in net sales, $37 million in EBIT, and $0.08 in EPS. The adjusted results exclude the impact of the additional week in the prior year. Our comparisons of the full year 2015 with 2014 will exclude previously announced items.

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. Lastly, please mark your calendars for our planned FY16 earnings dates. We plan to release first-quarter earnings on November 24, which will include the new segments and pension and post-retirement benefit accounting changes with recasted prior year Q1 data. Shortly after we release our 10-Q, we will release the remaining recasted financials. The next three earnings dates are February 25, May 20, and September 1, 2016. With that, let me turn the call over to Denise.

Denise Morrison - *Campbell Soup Company - President & CEO*

Thank you, Ken, and good morning, everyone. Welcome to our fourth-quarter earnings call. This morning, I will offer my perspective on our performance, provide a progress report on several major strategic actions we initiated in 2015, including our redesigned enterprise structure and cost savings effort, and share my outlook and areas of focus for FY16.

At our Investor Day in July, I described how the food industry is in a period of revolutionary change, which presents both challenges and opportunities for Campbell. The changes in the industry are being driven by several seismic shifts: new global economic realities in the US and abroad; major demographic changes and the redefinition of the American family; profound changes in consumer preferences for food, with greater focus on health and well being; and the impact of digital technologies on marketing, shopping and the growing demand for greater transparency about food. The convergence and acceleration of these shifts are reshaping the consumer and retailer landscape. Combined with the prevailing industry dynamics of consolidation and cost cutting, these shifts are placing increased pressure on traditional center store categories and mainstream food companies. With this as context, I'll focus my remarks this morning on our performance for FY15, review the important strategic actions we initiated during the year and highlight our key drivers for FY16.

First, I'll briefly comment on our fourth-quarter results. I'm pleased that we finished FY15 in line with our revised expectations. Sales in the fourth quarter reflected the tough consumer operating environment, with organic sales increasing 1%. Three of our five segments grew organic sales in the quarter. More importantly, we made significant progress in our internal actions to address our supply chain issues related to shipping capacity and customer service. We also made substantial strides to improve our cost structure through our cost savings initiatives and enterprise redesign.

We reported the largest gross margin improvement in more than six years. Adjusted EBIT and earnings per share increased 5% in the fourth quarter. I was particularly pleased with the fourth-quarter organic sales and earnings performance in US simple meals, as well as organic sales growth in Bolthouse and foodservice. In the quarter we also completed the acquisition of Garden Fresh Gourmet, a fresh salsa and hummus business that will provide a platform for our further expansion in the deli section.

Turning to our full-year results, with a solid finish we delivered sales, adjusted EBIT and adjusted EPS consistent with our most recent guidance. Organic sales increased 1%, with growth in four of our five reporting segments. Adjusted EBIT was down 2% for the year and adjusted gross margin declined 70 basis points for the year, within the range that we had expected. As I look at the year, I am pleased that our management team responded to our first-half cost and margin challenges in a difficult operating environment. I am particularly encouraged with the improvement in gross margin we delivered in the back half, and the fact that we posted organic sales growth in four of our five reporting segments; however, we recognize that we have more work to do.

Before Anthony provides you with a detailed review of our results, I will offer my perspective on several notable items, focusing on the full year. Looking at the year, within US simple meals, the performance of our sauce business was a stand out, notably Prego and Campbell's dinner sauces. Prego had another strong year behind the success of our white sauces and overall product superiority. Sales of Campbell dinner sauces increased double-digits for the year. Our strategically important Plum business drove double-digit sales growth with new products and continued distribution gains, especially in the grocery channel. In US soup, consumer take-away was relatively stable and we posted positive share performance.

For the year, our global baking and snacking segment performed well. Organic sales increased 3% and operating earnings were up 5%. I feel particularly good about the improvement in Australian biscuits, as the team made significant progress in this important core business. In Southeast Asia, our Indonesia business delivered another year of double-digit growth, but sales declined in the fourth quarter as a result of worsening economic conditions in this market, which we expect to persist.

We had another year of decline in shelf-stable US beverages. While the category remains challenged, the underlining trends of our business are beginning to show signs of improvement. Consumer take-away and share increased in the fourth quarter. Modest sales declines in V8 red juice were more than offset by the introduction of V8 Veggie Blends. Trial and repeat of Veggie Blends continued to meet expectations and depth of repeat remains strong. We expect our new advertising campaign to drive additional trial. V8 Splash, our powerhouse brand for kids, and V8 +Energy continued to perform well. In our immediate consumption channel, we're beginning to see some momentum. We feel good about the overall direction of this business, but we still face challenges particularly with the continued decline of our V-Fusion franchise. In FY16, the entire category will remain under significant pressure. While we expect our US beverage businesses to improve, we're not planning on a return to growth.

Let's now turn to the Bolthouse and foodservice segment. As a reminder, Bolthouse Farms consists of the farms and CPG businesses. Farms includes our retail fresh carrots business and our ingredients business, mainly carrot concentrate. CPG consists of our super-premium beverages, ultra-premium beverages and refrigerated salad dressings. We continue to be enthusiastic about Bolthouse Farms, especially the branded CPG business. For the year, CPG sales increased high single-digits. Gains were driven by product innovation, increased distribution for beverages and incremental shelf space at existing customers for our salad dressings. The initial roll-out of our cold press organic ultra-premium beverage line 1915 by Bolthouse Farms is off to a good start. After completing the acquisition of Garden Fresh Gourmet in June, we have begun integrating the business. Thus far there have been no surprises and we're pleased with the retailer response to our long-term plans.

FY15 was an eventful year and we took important steps to lay the foundation for the future. We redesigned our enterprise structure and our three new divisions are now operating in line with their declared portfolio roles. We established our integrated global services organization and moved elements of finance, procurement, marketing, sales, HR, and IT into this shared service group. It's early days but we're off to a solid start. The focus in FY16 will be working smarter, creating efficiencies, and reducing costs, while starting to build new enterprise capabilities within this group. We initiated plans for a zero-based budgeting process. We're piloting ZBB in two cost categories in FY16, with plans to expand in the future. We believe this discipline will be of great value to Campbell going forward.

We're off to a very good start to realizing our $250 million cost savings target. We delivered earlier-than-expected savings of approximately $85 million across several categories, including headcount reductions, non-working marketing, reduced travel expenses and spending on consultants. We added another growth engine with the acquisition of Garden Fresh Gourmet to bolster our Campbell fresh portfolio and extend our presence in the perimeter beyond produce into the deli section.

We initiated an important project to increase consumer trust by providing greater access to information about the ingredients we use and how we make our food. This is accelerating meaningful changes to our recipes. For instance, over time we are planning to eliminate artificial colors and flavors from nearly all of our North American products.

Looking ahead to FY16, we plan to deliver moderate growth in what we believe will continue to be a consumer environment marked by caution. As we outlined at our Investor Day in July, starting in the first quarter of FY16, we'll change our reporting segments reflecting our three new divisions, each with a distinct portfolio roll.

In our Americas simple meals and beverages division, we will focus on driving moderate growth while expanding our margins. We'll deliver this by focusing on fewer, bigger initiatives that will attract new consumers while driving additional consumption by our loyal core consumers. For example, our Campbell's Fresh Brewed Soups in K cups will provide a new convenient way for consumers to enjoy soup. This represents an incremental eating occasion that taps into the growing frequency of smaller meals and snacks. Additionally, we'll take an industry leadership role by increasing our transparency efforts. We'll provide greater access to information about more of our North American products on the whatsinmyfood.com website. We also plan to improve more of our recipes consistent with our purpose.

In global biscuits and snacks we're focused on expanding in developed and developing markets while improving our margins. In the developed markets of the United States and Australia, we're concentrating on restoring improved levels of growth. In the US, we'll apply a disciplined focus to consumer-driven innovation, increased marketing behind our Goldfish and Milano brands and fuel growth in our fresh bakery portfolio. In Australia we'll continue to improve our core shapes products and drive Tim Tam's momentum while shifting our marketing mix towards digital.

We'll also remain focused on faster-growing spaces, building on markets where we have a foothold such as Indonesia and China. We'll monitor and adjust to the economic conditions in both these countries throughout the year. We recognize that there may be short-term economic pressure in these markets. In the long term, we believe that it's essential to become more geographically diverse with a higher percentage of our business in faster-growing developing markets with an expanding middle class.

In the Campbell fresh division, we'll make focused investments to accelerate sales growth and expand into new categories. As we outlined at Investor Day, our priorities are to build on the successful launch of our ultra-premium offering 1915. The product is in 2,000 stores today and we expect to expand to 8,000 stores during the first quarter. We will continue to accelerate our refrigerated salad dressing business through innovation and increased distribution. And finally, we will integrate the Garden Fresh Gourmet acquisition and our existing refrigerated soup business into the Bolthouse Farms fresh platform and significantly expand our market penetration. We expect our C-Fresh business to become a full force growth engine for Campbell.

Across all of our businesses, we'll continue to actively explore external development opportunities that make both strategic and economic sense. We will also remain focused on transforming our cost structure and culture. We're off to a promising start with our cost reduction efforts, but we must remain diligent and continue to create an ownership mind set where employees treat every dollar as if it were their own.

In closing, I'm cautious but optimistic about FY16. I believe that the strategic imperatives we're pursuing, purpose and transparency in our core business, digital marketing and eCommerce, health and well being and expansion in developing markets, coupled with our division's clear portfolio roles, position us well for the year ahead. We're very clear-eyed about our challenges, particularly driving sustainable sales growth. But we're now better organized and better prepared to meet those challenges head on.

We believe that our strategy to focus on driving growth, aggressively reducing cost and reinvesting a portion of the savings in the areas of our business with the greatest growth potential is the best way to create shareholder value. I look forward to answering your questions in a few minutes. Now let me turn the call over to our Chief Financial Officer, Anthony DiSilvestro.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Thanks, Denise, and good morning. Before reviewing our results and guidance, I wanted to give you my perspective on our performance and future outlook. We finished the year with a solid quarter. I'm very pleased with our gross margin performance in the fourth quarter, which improved by 180 basis points, benefiting from our price realization and productivity effort. The improved gross margin and earlier-than-expected cost reductions drove 5% gains in both adjusted EBIT and the EPS for the quarter, despite a 2-point negative impact from currency translation.

We've made very good progress against our three-year $215 million cost savings target, delivering about $85 million of savings in FY15. For the full year, we delivered results within our recent guidance ranges, with EPS of $2.46 at the top end of the range. Looking ahead to 2016, our guidance, when you exclude the impact of currency translation and the Garden Fresh Gourmet acquisition, is within our new-long term target.

Now, I'll review our results in more detail. For the fourth quarter net sales on an as-reported basis declined 9% to $1.7 billion, primarily due to the impact of one less week and the negative impact of currency translation. Excluding those factors, and our recent acquisition of Garden Fresh Gourmet, organic net sales increased 1% in the quarter as we benefited from higher selling prices. Adjusted EBIT increased 5% to $234 million driven by a higher gross margin percentage, partly offset by higher incentive compensation expenses, and a 2-point negative impact from currency translation. Adjusted EPS also increased by 5% to $0.43.

For the full year reported net sales declined 2% with organic sales gaining 1%, led by the strong performance of our global baking and snacking segment. Adjusted EBIT declined 2% to $1.2 billion reflecting a lower gross margin percentage, a 2-point negative impact from currency translation and higher incentive compensation expense, partly offset by volume gains and the benefit of our cost savings initiatives. The decline in gross margin, down 70 basis points, was driven by higher-than-anticipated cost inflation and the supply chain issues we experienced in the first half, partly offset by productivity and pricing gains. EPS of $2.46 was comparable to the prior year.

Decomposing our sales performance for the quarter, as-reported sales declined 9% with organic sales increasing by 1%. Volume and mix subtracted 1 point, which was primarily in our global baking and snacking and US beverages segments. Higher selling prices as across four of our reportable segments added 1 point to sales.

Reduced promotional spending contributed 1 point to sales growth, primarily driven by the global baking and snacking segment. Currency translation had an adverse impact of 3 points. Our two primary foreign currencies, the Australian dollar and Canadian dollar, both continued to weaken against the US dollar. Our recent acquisition of Garden Fresh Gourmet added 1 point to sales and the impact of one less week subtracted 7 points.

Our adjusted gross margin percentage increased by 180 basis points to 36.1%. For the quarter, and moderating relative to earlier quarters, inflation increased by approximately 2%. Inflation and other factors had a negative impact on gross margin of 1.1 points. Mix had a negative impact of 40 basis points.

In aggregate, our price realization actions have contributed 1.2 points of margin expansion, with 40 basis points from reduced promotional spending, principally trade reductions in Pepperidge Farm and 80 basis points from higher selling prices, primarily on condensed soup, Prego, and in Canada. Lastly, we continued to drive meaningful productivity gains in our supply chain, which contributed 210 basis points of margin improvement in the quarter. Overall, our operating efficiencies were above prior-year levels.

Marketing and selling expenses declined by 7% in the quarter, reflecting impact of currency and reductions in selling expense and non-working marketing, both benefiting from our cost management efforts, partly offset by an increase in advertising and consumer promotion expense. Adjusted administrative expenses increased 10%, driven by higher incentive compensation costs compared to the prior year in which the expense was significantly below targeted levels.

For additional perspective on our performance, this chart breaks down our EPS change between our operating performance and below-the-line items. As you can see, adjusted EPS increased $0.02 compared with the prior year, increasing from $0.41 to $0.43 per share. On a currency-neutral basis, growth in adjusted EBIT contributed $0.04 to EPS.

Net interest expense declined $3 million, about $0.01 per share, primarily due to the impact of one less week. With $200 million of share repurchases throughout the year under our strategic share repurchase program, this has reduced our share count and added $0.01 to EPS in the quarter. Going the other way, our adjusted tax rate for the quarter was 34.8%, up 80 basis points versus the prior year, reflecting a shift in the mix between US and foreign earnings and negatively impacting EPS by $0.01. Currency had a $0.01 negative impact on EPS in the quarter, completing the bridge to $0.43.

Now turning to our segment results. In global baking and snacking, our largest sales segment in the quarter, organic sales increased 1% as growth in Pepperidge Farm and Arnott's were partly offset by a decline in Kelsen. Sales gains in Pepperidge Farm were driven by fresh bakery, Goldfish Crackers and frozen products, partly offset by a decline in cookies. Organic growth in Arnott's reflected gains in Australia, partly offset by a decline in Indonesia. Operating earnings declined 26%, driven by the impact of one less week, higher marketing and administrative expenses, principally incentive compensation, currency translation and impairment charges to minor trademarks, partly offset by gross margin expansion. Excluding the impact of one less week, currency translation and the impairment charges, operating profit increased in the quarter.

In US simple meals organic sales increased 4%. While dollar consumption of soup in measured channels increased 1%, movements in retail inventory levels contributed to sales gains in the quarter. As you may recall, movements in retail inventory levels had a negative impact on third-quarter sales and we're experiencing the opposite effect in the fourth quarter. We ended the year with retail inventory levels comparable to the prior year.

Organic sales in other simple meals increased driven by the continued strong growth of Prego pasta sauce. Segment sales also benefited from higher selling prices in condensed soups and Prego pasta sauce. Operating earnings increased 4%, reflecting organic sales growth, productivity improvements and benefits from our cost savings initiatives, partly offset by cost inflation and the impact of one less week.

In the Bolthouse and foodservice segment organic sales increased 4%, with growth in Bolthouse Farm beverages and salad dressings and in North America foodservice, partly offset by declines in Bolthouse Farms carrots. Operating earnings fell 3% on higher administrative expenses and the impact of one less week.

US beverage organic sales fell 4% primarily due to volume losses in V8 V-Fusion. While consumer take-away dollar sales in measured channels was positive, sales were negatively impacted by reductions in retail inventory levels and sales declines in the club channel. Operating earnings declined 23% due to the sales declines, including the impact of one less week.

International simple meals and beverages organic sales decline 5% from weakness in Canada and Australia. Operating earnings declined $10 million or 48%, primarily due to volume declines including the impact of one less week and currency translation.

This chart shows the as-reported sales performance of US soup unadjusted for the impact of one less week, which subtracted 7 points in the quarter and 1 point for the full year. For the quarter, US soup sales declined 2%, with condensed down 4%, ready-to-serve down 3% and broth up 11%.

Excluding the impact of one less week, sales of condensed soups increased, with gains in both eating and cooking varieties driven by net price realization. Sales of ready-to-serve soup also increased excluding the impact of one less week, primarily driven by the launches of our Fresh Brewed Soup for Keurig, and our line of organic soups. The double-digit sales gain on Swanson Broth was primarily lead by aseptic varieties. For the fiscal year, as shown towards the bottom of the chart, soup sales declined 3% versus the prior year, as a 3% decline in condensed and a 5% decline in ready-to-serve were partly offset by 3% growth in broth.

Here is the US wet soup category of performance and our share of results as measured by IRI. For the 52-week period ending August 2, 2015 the category as a whole declined 0.9%. Our sales in measured channels decline 0.7% with weakness in ready-to-serve soups, partly offset by gains in broth. Our share increased 10 basis points in the last 52 weeks and has now been relatively stable for three years. Other branded players in aggregate had a share of 28.1%, declining 30 basis points while private label with a 12.6% share gained 20 basis points.

We had strong cash flow performance in FY15. Cash from operations increased by $283 million to almost $1.2 billion, driven by lower working capital requirements, wrapping the taxes paid in 2014 on the divestiture of the European simple meals business and lower pension contributions. Capital expenditures increased to $380 million as we increased capacity in Goldfish, Bolthouse Farms beverages, broth in North America and biscuits in Indonesia. We paid dividends totaling $394 million, reflecting our current quarterly dividend rate of $0.312 per share.

In aggregate, we repurchased $244 million of shares in FY15, $200 million of which were under our strategic share repurchase program. The balance of the repurchases were made to offset dilution from equity-based compensation. Net debt increased by approximately $60 million to $3.8 billion, as gains in cash flow were more than offset by the $232 million acquisition of Garden Fresh Gourmet.

Now, I'll review our FY16 guidance. The Company expects to grow sales by 0% to 1%, adjusted EBIT to grow by 3% to 5% and adjusted EPS to grow by 3% to 5% or $2.53 to $2.58 per share. This guidance includes the estimated negative impact of currency translation of 2 points across sales, EBIT and EPS. This guidance also includes the impact of the Garden Fresh Gourmet acquisition, which is estimated to contribute 1 point to sales and EBIT growth. The acquisition is neutral at EPS, including the impact of reducing our anticipated share repurchases to repay the acquisition debt.

Excluding the impacts from currency headwinds and the acquisition, these growth rates are within our long-term growth targets of 1% to 3% organic sales, 4% to 6% for adjusted EBIT and 5% to 7% for adjusted EPS. While we don't give quarterly guidance, I will say that we expect some sales headwinds in the first quarter, given we're cycling a strong first quarter from last year and from timing related to our promotional strategies.

As announced this morning we intend to adopt mark-to-market pension and post retirement benefit accounting in the first quarter of FY16 and recast our historical results. This change eliminates the deferral and subsequent amortization of historic actuarial gains and losses, which will be recognized as incurred. The periodic mark-to-market adjustment will be reflected as an item impacting comparability and therefore excluded from adjusted results. We believe this accounting change will improve the transparency of our results and year-to-year comparability. The 2016 guidance does not reflect the impact of the anticipated accounting change; however, 2016 growth rates are not expected to change from the recasted 2015 base.

As we operationalize our new division structure beginning in the first quarter of FY16, we will move from our current five reporting segments to three, Americas simple meals and beverages, global biscuits and snacks, and Campbell fresh. Historical results reflecting both the new segments and change in accounting will be provided shortly after we file our first-quarter 10-Q.

Turning to some of the key assumptions underlying our guidance, we expect inflation and costs of products sold of approximately 2% to 3%, including the negative impact of a stronger US dollar on the input costs of our international businesses. Cost inflation will be offset by gains from our ongoing productivity program which, excluding our ZBB initiative, it's targeted at 3% of cost of products sold.

We expect our gross margin percentage to improve modestly as we continue to achieve net price realization and improve our supply chain performance. We are approving incentive compensation below target levels in 2015 and anticipate a headwind of approximately $0.04 per share in 2016. The effective tax rate is estimated to be in the range of 31% to 32% compared to the 2015 adjusted rate of 31%. This guidance assume about a $0.02 per share incremental contribution from share repurchases which are expected to be at levels below FY15. We are forecasting capital expenditures to decline by $30 million to approximately $350 million, which is more in line with our historical spending levels.

In FY15, we launched a comprehensive reorganization and a three-year cost reduction initiative, leveraging a zero-based budgeting approach and targeting annual savings of $250 million. As shown on the chart, we have achieved about $85 million of savings in 2015 as we reduced headcount and realized savings across several cost categories. For 2016, we are targeting to increase the savings run rate to $145 million, which would put us more than half way to our $250 million goal. Most of the 2016 gains will come in the selling and marketing and administrative expense lines. The majority of the more complex supply chain gains will come later in the program. To implement the program we estimate total program costs in the range of $250 million to $325 million.

In FY15, we recognized costs totaling $124 million, which includes $22 million of implementation costs and $102 million of restructuring charges, principally severance as we implemented both a voluntary incentive separation program and headcount reductions, as we've streamlined our organization. Against this program we estimate program costs of approximately $100 million in FY16. That concludes my remarks and now I'll turn it back to Ken for the Q&A.

Ken Gosnell - *Campbell Soup Company - VP of Finance Strategy & IR*

Thanks, Anthony. We will now start our Q&A session and since we have limited time, out of fairness to other callers if you could, please ask only one question at a time. Thanks.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Robert Moskow with Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Hi, thank you. The gross margin expansion obviously was much higher than what we all expected. Have you given any specific guidance for what kind of expansion you expect in FY16?

And also, was there any help in the quarter resulting from the mismatch of incremental costs that you took on in first and second quarter, Anthony? I remember there was some noise there related to some inefficiencies for extra costs that needed to be spread out over multiple quarters. Did that influence the fourth-quarter expansion at all?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Rob, I'll comment on the fourth quarter and come back to 2016. The fourth-quarter comp is fairly clean. The only thing that gave us some advantage this year relative to last year is the timing of the mark-to-market adjustment on our commodity hedges. We had a little bit of favorability this year relative to last year. A small portion of that 180 basis points is that, and the rest is improvement in the operating performance of the business.

In terms of 2016, as I said in my remarks, we expect to see a modest improvement in our gross margin percentage. I think the way to think about it, there's a number of positives and a number of negatives. On the positive side, our annual comps productivity program where we target 3% of comps, obviously that's the most significant benefit. We expect to see continued benefit on net price realization, mostly from the pricing actions we've taken in the back half of this year. We do expect to see margin improvement from improved supply chain performance year on year, given the challenges we have in the first half of last year.

On the negative side, three things to mention. One is cost inflation which we expect to be about 2% to 3%, and that includes the negative impact of currency on the input cost of a number of our international businesses. It also includes some negative mix. And lastly, the cost of quality improvements we are making in some of our both our products and packaging.

Robert Moskow - *Credit Suisse - Analyst*

Okay, I'll let it go. Thanks.

Operator

Our next question comes from John Baumgartner from Wells Fargo.

John Baumgartner - *Wells Fargo Securities, LLC - Analyst*

Thanks, good morning. Denise, wanted to ask about global baking and snacking and the volume pressure there. Maybe if you could address in a bit more detail, some of that pressure in Asia, particularly Kelsen in China.

And in the US cookie business and the softness here, it seems that Pepperidge pricing began to outpace the category over the past few months. Are you seeing some elasticity impact there? And how are you thinking about that for FY16?

Denise Morrison - *Campbell Soup Company - President & CEO*

Let me start first with our core business in the United States and in Australia. We are pleased with the share in consumption of Goldfish crackers and in particular Milano, although we did experience in the quarter some softness in cookies.

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That was pretty much as expected because in the biscuit business in the United States, particularly in the quarter, we did not promote as heavily as last year, because the promotions were not as productive as we would have expected. So that was pretty deliberate. But we expect moderate growth in the United States on our biscuit business.

In the Australian business we're really happy with the year that we had there. That has been a pretty remarkable turnaround. We were challenged in Australia for a couple of years and they have now posted really outstanding results. Its been really on the fundamentals, better advertising, more innovation, more brand building, more digital. So we believe that the building blocks they've put in place there are very sustainable.

We had a great year in Indonesia with double-digit growth, but we did have a slow fourth quarter. All you have to do is pick up a newspaper to see what's going on in Asia these days. But we're watching that very carefully, and we believe we have a lot of runway in Indonesia to expand our distribution points, but we're going to be very responsible about that business in 2016.

And then the Kelsen business, this is a very small quarter for Kelsen. The sales are skewed in China largely towards Chinese New Year. But that said, we did have some inventory overhang from Chinese New Year this year, and we're working through that right now. That hit us predominantly in the fourth quarter.

John Baumgartner - *Wells Fargo Securities, LLC - Analyst*

Great, thank you, Denise.

Operator

Our next question comes from Chris Growe with Stifel Nicolaus.

Chris Growe - *Stifel Nicolaus - Analyst*

Hi, thank you, good morning.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hi, Chris.

Chris Growe - *Stifel Nicolaus - Analyst*

Hi, just a quick question if I could, then. I just want to get a sense of the degree of promotional spending and what you expect that to do across the year. I know every business is different, and I'm sure broadly you have expectations for each business. Is there an overall comment you can make on promotional spending? Maybe related to that, advertising. I'm not sure I heard what you expect for advertising spending for the year. Thank you.

Denise Morrison - *Campbell Soup Company - President & CEO*

Yes, we are continuing to manage our trade promotions to maximize our profitable volume. We're maintaining a focus on competitive activity in both our customer programs and in our consumer response. And we are, as noted, looking for opportunities to improve our trade spending, not only for ourselves to get a better return, but also for our customers to get a better return. So there's no real strategy to cut back, but there definitely is improved analytics and revenue management so we have a much more productive trade spend. In total, our advertising consumer and trade was about 24% of sales, which we try and aim for about 24% to 25% as a rule.

Operator

Our next question comes from Jason English with Goldman Sachs.

Jason English - *Goldman Sachs - Analyst*

Hey, good morning, folks.

Denise Morrison - *Campbell Soup Company - President & CEO*

Good morning.

Jason English - *Goldman Sachs - Analyst*

First, a quick housekeeping question. Can you guys quantify what the 2015 EPS base is going to look like post the recasting related to pension accounting?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Sure, I can do that. I think the way to think about it in 2015, the amortization within our pension expense is going to be about $100 million pretax. That's a good proxy for the impact of the accounting change when we get through a bunch of pluses and minuses. I think a couple additional points on this. These plans have been closed to new hires for a couple of years. Now they're very well funded; we ended the year at 97% to 98% in term of funded status. We don't expect to make any contributions to our US plans in 2016.

Jason English - *Goldman Sachs - Analyst*

Thank you, that's helpful. And you mentioned ZBB focused on two cost categories. Can you specify what categories those are?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes, we did a pilot program on our non-working marketing and also on the consulting.

Jason English - *Goldman Sachs - Analyst*

And on marketing, you're focusing on more productivity there. It's down around 17% from your FY10 high. How much further can you go? As you try to balance and walk the line of containing promotions, and I think it's encouraging to see promotions actually being a positive contributor to sales, can you do both at the same time? Can you continue to hold the line on marketing and find efficiencies there, while at the same time pulling back or finding efficiencies on trade spend? Or is it an either/or type situation as you think about the forward?

Denise Morrison - *Campbell Soup Company - President & CEO*

I think that we look at the marketing mix as the three elements of advertising, consumer and trade. Of course that mix is going to vary by business in terms of what degree we spend, but we do have some shifts going on. As Anthony alluded to, we are making a conscious effort to reduce our non-working marketing where it's not a productive spend. The second is within advertising, we are shifting more dollars out of conventional TV and more into digital. That spend has been shifting over time, but will be up to 40% going forward. And then we try, again, for ACT to stay in the range of about 24% to 25% of sales and that's remained pretty constant over the last couple of years.

Jason English - *Goldman Sachs - Analyst*

Thank you very much, I appreciate the color. I'll pass it on.

Operator

Our next question comes from David Palmer with RBC.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hi, David.

Operator

David, if your line is on mute can you please unmute it? We'll move on to our next question. Our next question comes from Ken Goldman with JPMorgan.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hi, Ken.

Ken Goldman - *JPMorgan - Analyst*

Hi good morning. Real quick one. Regarding US simple meals, and forgive me if you mentioned this, but you talked about positive movements in the retailer inventory levels. Can you elaborate a bit on how much that helped and what happened that your customers loaded up a bit on purchases versus the prior year?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes, I think it's more about how we came into the quarter. If you recall the third quarter, I think our sales were down 10% while our consumption was only down 1%. So we came into the quarter with inventory levels down. We ended the quarter and the year with retail inventories about where they were a year ago. In the fourth quarter, while our consumption was plus 1%, our organic sales were plus about 5%. So we had about 4 points of lift from that shift in inventory.

Ken Goldman - *JPMorgan - Analyst*

Thank you. Then a quick one if I can. Denise, in terms of US cookies, your two main competitors have made some DSD investments there. Can you talk about where you think those investments have affected your business at all negatively? And whether you might want to add to your capability there to match what some of your peers have done?

Denise Morrison - *Campbell Soup Company - President & CEO*

I can't comment really on competition's investments, but I can say that we continue to be very supportive of our independent distributer networks. They are a large part of our business model and we'll continue to build the business alongside of them.

Ken Goldman - *JPMorgan - Analyst*

Thanks very much.

Operator

Our next question comes from Matthew Grainger with Morgan Stanley.

Matthew Grainger - *Morgan Stanley - Analyst*

Hi, good morning, everyone.

Denise Morrison - *Campbell Soup Company - President & CEO*

Good morning.

Matthew Grainger - *Morgan Stanley - Analyst*

Denise, I wanted to come back to the outlook for US beverages in 2016. It sounds like you're still cautious, definitely from a sales perspective. But is it possible that we could begin to see some improvement in margin or profit growth? As you think about the growth profile of that business, given how persistent volume declines have been, do you think there may be an opportunity to perhaps take a more profit maximizing approach, perhaps focus a little bit more on pricing realization?

Denise Morrison - *Campbell Soup Company - President & CEO*

We're doing both. Obviously the category itself has been under a lot of pressure, based on the consumer. What we've been really focused on is how do we broaden our line and better deliver on the things that consumers are looking for in vegetable juices. And we believe that vegetable juices have an advantage, based on the consumer trends.

We learned a lot from Bolthouse. Actually our V8 Veggie Blends reflect a broadening of vegetable-based beverages, based on consumer preferences for those particular flavor profiles. We think that is really taking the business in the right direction. That said, we still have a leaky bucket in our V8 V-Fusion that we're dealing with. Our V8 Splash and V8 +Energy are doing really well and our immediate consumption has now posted the second quarter of growth. So we've got some good signs on the growth curve, but more things working than not. But we still are cautious about declaring victory yet.

The other thing we're working on is mastering complexity project in our supply chain, which we believe will have a really positive impact on our profit going forward. But that is a longer-term play.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay, thanks. And to come back to some of the more on-trend new products like V8 Veggie Blends, is that something, maybe not initially, but something that you feel can be rolled out in more of a margin-neutral way, given the added quality components of it?

Denise Morrison - *Campbell Soup Company - President & CEO*

The brand Veggie Blends is showing some really good trial and repeat. We believe we do have to invest marketing to drive the trial because the repeat is so strong. Building a new product today is heavy lifting, so making sure that we break through and we're supporting the brands we put out there is an important idea.

Matthew Grainger - *Morgan Stanley - Analyst*

Sure. Okay, thanks, Denise.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Hey, good morning, everyone.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hello, Bryan.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

A quick question about the cost inflation assumption for 2016. Can you give us some color around where the inflation pressure is? Especially more recently you've seen some commodity movements that would presumably be more favorable. And also to what degree your inflation assumption for 2016 reflects some incremental costs related to the ingredient changes?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Sure, I can give you a little more color on that. So overall, like I said earlier, the cost inflation of about 2% to 3%. If you parse that apart and look at the core ingredients in packaging and energy components, it's about 1%. Within that, the key drivers would be about five categories: vegetables, flavors, sweeteners, chocolate. And we have a significant increase as a result of the avian flu in both eggs and pasta. In eggs we're looking at inflation rates of close to 50% in FY16. So those are the key drivers of the 1%.

Then on top of that, there's a couple of other items. First would be, and I alluded to it, the FX impact of input costs on our Canadian business and the Australian business is fairly significant. Then the other couple of pieces, one would be wage rates within the supply chain, and also benefits, both healthcare and pension. In terms of the commodities, because you mentioned some of the prices coming down, we're locked into about 75% of our commodities for FY16.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay, great, that's very helpful. Have a great Labor Day weekend, everyone.

Denise Morrison - *Campbell Soup Company - President & CEO*

Thanks, you too.

Operator

Our next question comes from Jonathan Feeney with Athlos Research.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hi, Jonathan.

Jonathan Feeney - *Athlos Research - Analyst*

Hi, how are you? Good morning. One question I had. I wanted to get more detail about the -- you mentioned retailer inventories, particularly within simple meals. Any kind of detail you can give us about how sustainable those are, particularly in broth, where sales are particularly strong, what went on. And more detail by channel? I know you discussed it a little bit, but are there any particular retailers who are moving inventories around in a way that affected profit this quarter? Thanks.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

No, other than the comment I made earlier that we came into the quarter with inventories below last year. It's a rocky road; we started the year and ended the year about the same place, which isn't a lot of retail inventories. The issue that we saw all throughout the year was the quarterly volatility, starting with the first quarter with the timing of the holiday change because we had one less week in the fiscal year. Then some timing in the third quarter, where we pulled back quite a bit on some of our promotional activity in soup, and that led to some reduction in retailer inventories. That corrected in the fourth quarter. I would say again, we ended the year at relatively low levels, comparable to a year ago and I can't think of any particular anomaly within that, Jonathan.

Denise Morrison - *Campbell Soup Company - President & CEO*

The drivers are really that inventory movement is largely a function of promotional activity. As we're noting, the activity's not consistent quarter to quarter. Inventory changes are largely individual customer decisions. So those are three other points that round out the discussion.

Jonathan Feeney - *Athlos Research - Analyst*

Great, well thanks so much.

Operator

Our next question comes from David Driscoll with Citi.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hi, David.

David Driscoll - *Citi Research - Analyst*

Thank you, good morning. Denise, I wanted to ask a little bit about this new segment Americas simple meals and beverages. Really to ask about the margin opportunity that's there for the segments. I want to say something that I feel like that there's been almost a basic philosophical shift here, such that the focus moves from what I perceive in the past as this maniacal focus on volumes, to a very different business focus for that segment now just going to profits.

So number one, am I right? Am I overstating the philosophical shift? Can you give us some dimensions on the margin opportunity? I'm not too concerned about the timelines. This is not a FY16 question, I really want to understand big picture where it's going.

Denise Morrison - *Campbell Soup Company - President & CEO*

I think expecting that business to grow moderately at the top line and expand margins is a more balanced approach to the portfolio, in terms of expecting these categories to do what they can do. That doesn't mean that we won't have pockets of growth. For example, the Plum business resides in that division, and we expect robust growth from Plum. We also are not taking our foot off the gas on innovation, but we're being a lot more selective about the innovation we put into the marketplace, because we're in a different place. A couple years ago we didn't have a pipeline. What happened as a result are some little ideas got out into the marketplace. Today we have built a pipeline and we could be more choiceful about the larger ideas where we know we're going to get an impact from. So I think this is a much more responsible way to run this business. We believe that we can deliver better value for our shareholders with this approach.

David Driscoll - *Citi Research - Analyst*

Is there any way to put a guideline to this margin expansion? I'm trying to get a sense of is this 10, 20 basis points a year? Or is this something that has bigger potential than that?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I would say -- let me put it this way, I think there's an opportunity over time to grow the profit in that division above the Company target.

Denise Morrison - *Campbell Soup Company - President & CEO*

And it has been eroding for the past couple of years. So by getting into our cost structure and getting into the discipline of zero-based budgeting, we're going to be able to do this in a very surgical way, so that it sticks and is sustainable.

David Driscoll - *Citi Research - Analyst*

I really appreciate the comments, thank you so much.

Operator

Our final question comes from Diane Geissler with CLSA.

Denise Morrison - *Campbell Soup Company - President & CEO*

Hi, Diane.

Diane Geissler - *CLSA Limited - Analyst*

Good morning.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Good morning.

Diane Geissler - *CLSA Limited - Analyst*

I wanted to ask about the soup category; we're heading into the start of the soup season here. It seems anecdotally the category is a little promotional. I'm sure it's probably promotional every fall because it is the high season. Could you talk a little bit about what you're seeing on shelf and from the retailers, in terms of the levels of support they're looking for? And is there any divergence from what you've seen around this time every year?

Denise Morrison - *Campbell Soup Company - President & CEO*

It's early days in the season. Right now what we're focused on is making sure that our shelf space is intact and the products are merchandised correctly on shelf. We have new products that are being cut in, like the K cups and organic soup, making sure that's sufficiently placed. Our Campbell sales team is working with customers on a robust promotion schedule, but pretty consistent with what we've had in prior years. So at this point in time, I don't see anything unusual. I don't know, Anthony, if you have anything to add.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

No.

Diane Geissler - *CLSA Limited - Analyst*

And the K cups, how will you account for those? What do you consider those, condensed? Or ready-to-serve?

Denise Morrison - *Campbell Soup Company - President & CEO*

We actually believe they will be largely incremental to the category because it is an incremental usage occasion, going after soup as a snack. We believe that there's a great overlap between our Campbell soup users and Keurig users. Our research has confirmed that. We are shelving it in the coffee aisle in about 70% of the retail environment. That's basically because we believe that people who are interested buying K cups will see this as a real positive in terms of expanding the usage of their dispensers into new categories and new usage occasions.

We have two pack sizes. One designed to drive trial, which we're situating in the soup aisle, and that's a two-count pack. And then a six-count pack in the coffee aisle. We're pretty excited about it. It's going to be different, but we believe that the space has really been a game changer for coffee. And we expect some good things from it.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

The segment classification is a good question and I'd have to think about that. What we'll do is when we get into the first quarter I'll make sure I highlight which segment we put that in.

THOMSON REUTERS

Denise Morrison - *Campbell Soup Company - President & CEO*

Okay. And how many flavors are in the K cups?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I think right now just two.

Denise Morrison - *Campbell Soup Company - President & CEO*

Yes, two.

Diane Geissler - *CLSA Limited - Analyst*

Okay, great, thank you.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

You're welcome.

Operator

And that does conclude the Q&A session. I'll turn the call back over to management for closing remarks.

Ken Gosnell - *Campbell Soup Company - VP of Finance Strategy & IR*

Thank you, everyone, for joining our fourth-quarter call and webcast. A full replay will be available about two hours after this call. You can go online or go calling 1-888-266-2081. The access code is 1660929. You have until September 17, at which point we move our earnings call strictly to the website, investor.campbellsoupcompany.com. Just click on recent webcasts and presentations.

If you have any further questions, please call me, Ken, at 856-342-6081. If you are a reporter with questions, please call Carla Burigatto, Director of External Communications, 856-342-3737. This concludes today's call. Thanks.

Operator

Thank you, ladies and gentlemen. That does conclude today's conference. You may all disconnect and everyone have a great day.