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CPB - Q2 2014 Campbell Soup Company Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 14, 2014 / 2:30PM GMT

OVERVIEW:

Co. reported 1H14 net sales from continuing operations of $4.4b, adjusted earnings from continuing operations of $449m, and adjusted EPS from continuing operations of $1.42. 2Q14 net sales from continuing operations were $2.3b, adjusted earnings from continuing operations were $240m, and adjusted EPS from continuing operations was $0.76. Expects FY14 net sales growth from continuing operations to be 4-5%.

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Campbell Soup second-quarter 2014 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 follow at that time. (Operator Instructions). As a reminder, this call is being recorded. I would now like to introduce your host for today's conference, Jennifer Driscoll, Vice President of Investor Relations. Please go ahead.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Thanks, Kate. Good morning, everybody. Welcome to Campbell Soup Company's second-quarter earnings call and webcast. With me here in New Jersey today are Denise Morrison, President and CEO; Craig Owens, Senior Vice President, CFO and Chief Administrative Officer; Anthony DiSilvestro, Senior Vice President of Finance; and Anna Choi, Senior Manager of Investor Relations.

I am going to comment first on some very exciting items impacting comparability in the quarter. Denise will follow me with a high-level perspective on our second quarter and first half. Craig will wrap it up with a more detailed look at our financial and segment results. After that, we will take your questions.

As usual, we have created slides to accompany our earnings presentation. You will find the slides posted on our website this morning at investor.campbellsoupcompany.com and on our IR app, which is available through Google or Apple. Please keep in mind that our call is open to members of the media who are listening and are participating in listening-only mode.

Our presentation today includes forward-looking statements. They reflect the Company's current expectations about future plans and performance. Our forward-looking statements rely on a number of assumptions and estimates, which could be inaccurate and are subject to inherent risks. Please refer to slide 3 in the presentation or to the Company's most recent Form 10-K and subsequent SEC filings for a list of the factors that could cause our actual results to vary materially from those anticipated in our forward-looking statements.

In the second quarter of fiscal 2014, Campbell and our joint venture partner agreed to restructure manufacturing and streamline operations in China. We recorded pretax restructuring charges of $13 million related to this initiative. In the first quarter, we recorded pretax restructuring charges and related costs of $23 million associated with initiatives to streamline our salaried workforce in North America and in Asia-Pacific and for previously announced initiatives.

We recorded a loss of $9 million on foreign exchange forward contracts used to hedge the proceeds from the sale of our European Simple Meals business. In addition, we recorded tax expense of $7 million associated with that sale. Last quarter in the second -- or last year in the second quarter, we recorded a pretax restructuring charge and related costs of $48 million related to our US supply chain in Mexico. In the first quarter, we recorded $10 million in transaction costs for Bolthouse and $43 million in restructuring charges and related costs related to US supply chain initiatives.

Since our presentation today includes non-GAAP measures as defined by SEC rules, we have provided a reconciliation of the measures to the most directly comparable GAAP measures as an appendix to the slides accompanying our presentation. These slides, along with our earnings release and selected quarterly financials, also can be found on our website accessible by computer or on your mobile device with the Campbell IR app.

As Denise will touch on later too, Campbell recently announced a CFO transition. Craig Owens, CFO since October 2008, will be retiring on May 1, 2014. He has been not only a strong and respected CFO, but also an outstanding mentor to me and many others here at Campbell. And on behalf of all of us who have had the privilege to work with and laugh with Craig, I'd like to thank him for that.

So we are delighted to add that Anthony DiSilvestro is being promoted to CFO and he will be providing the financials perspective at the Consumer Analyst Group of New York conference, CAGNY, in Florida on February 19 with Craig, Denise and I attending as well. We invite interested shareholders, investors, members of the media and consumers to listen to and view our investor presentation at CAGNY, which will be videocast live -- actually videocast at 10.30 AM Eastern from Boca Raton. A replay of the video and copies of the materials will be available afterward in Campbell's website archives. With that, let me turn it over to Denise Morrison.

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

Thank you, Jennifer and good morning to everyone. Thanks for joining Campbell's second-quarter earnings call. I'd like to cover three topics this morning. I will share my perspective on our second-quarter and first-half results, update you on the unusual factors that negatively impacted our first quarter and how those played out in the second quarter and discuss our plans to drive stronger growth in the second half to deliver our full-year guidance. Craig will then provide details on our segment results.

Despite facing headwinds from a weaker retail and consumer environment, we continue to reshape our Company for longer-term higher growth while at the same time balancing short-term deliverables. In the second quarter, we delivered growth of 6% in reported net sales, 15% in adjusted EBIT and 19% in adjusted EPS from continuing operations, which increased to $0.76. Clearly, we made progress from our disappointing start in the first quarter. Our improved results were driven by growth in our core business and from acquisitions. We delivered 3% organic sales growth in our core business led by higher sales in US Simple Meals, Pepperidge Farm and Bolthouse Farms.

Acquisitions also contributed to our growth led by Kelsen, which we acquired in the first quarter to give us a growth platform in China and other developing markets. Kelsen was the main catalyst of our 14% growth in Global Baking and Snacking and contributed to the higher operating earnings. We had a strong holiday season in US soup and Pepperidge Farm, but January was weaker than expected. During the quarter, we also closed the sale of our European Simple Meals business.

Let me take you through the four factors that negatively impacted our first-quarter performance and explain how those factors played out this quarter. As we said in November, those Q1 drivers were movements in inventory levels by US retailers and program timing, weakness in our core business trends, our decision to frontload marketing spend in Q1 to support new products in soup and Simple Meals and build the Bolthouse Farms brand and our voluntary recall of a range of Plum Organic products.

We said in November that we expected a positive impact on second-quarter results as some of these drivers reversed. This, in fact, happened. Looking first at inventory movements, our US soup business benefited from positive retailer inventory movements in the second quarter as we anticipated. That was a change from Q1 when retailer inventory declines and higher levels coming into the year combined with later holiday timing hurt our Q1 results, especially in soup. Reflecting the reversal in inventory pressures, US soup shipments increased in the second quarter driving 5% sales growth. The late timing of the Thanksgiving holiday season also helped US soup and Pepperidge Farm as it pushed shipments into the second quarter as we expected. We had strong sales and consumption during the holiday season and well-executed holiday programs. For the quarter, sales of Campbell's condensed cooking soups grew double digits and Swanson broth was on fire, up 21%. We also grew sales of Pepperidge Farm bread and stuffing.

Let's look more closely at the second factor that we discussed back in November, our core business trends. In the second quarter, our core business performance improved, especially in US Simple Meals, which delivered 7% growth in sales and 12% growth in earnings. This performance reflected growth in soup, the acquisition of Plum Organics and higher sales of sauces, including our new innovation with Prego white sauces and Campbell's dinner sauces.

As we said in November, we began the fiscal year with a soup promotion plan that was more heavily weighted to the second and third quarters. Despite strong holiday consumption, we didn't get the overall lifts in soup that we had anticipated in the quarter from the balance of promotions. This caused soup shipments in the quarter to be ahead of consumption, which was down more than a point for the quarter. As a result, we ended the second quarter with inventory levels that were elevated from the year earlier quarter. So while we delivered growth in soup sales, we are far from satisfied with the category consumption and our consumption performance. Accordingly, we have more aggressive plans in the second half as I will explain in a few minutes.

Turning to Pepperidge Farm, we delivered 5% growth in Goldfish in the second quarter, including crackers and our new Goldfish Puffs. Sales of Pepperidge Farm cookies increased with growth in Dessert Shop cookies. Fresh bakery delivered solid performance as the business continued to innovate and leverage our shelf space gains. Sales in Bolthouse Farms increased 6% with double-digit growth in its premium refrigerated beverages and salad dressings. Bolthouse Farms continues to launch innovative new beverage products supported by increased merchandising. We continue to increase beverage assortment in the retail perimeter while we are still expanding points of distribution for salad dressings.

Our core US Beverage business and our business in Australia continue to face challenges. We told you previously that we don't expect US Beverages and our Australian business to be growth drivers this year and that hasn't changed. But we have taken several important steps in recent months to change the leadership in both of these businesses and build a stronger foundation for future growth.

In US Beverages, the second-quarter sales decline was largely driven by our planned transition from the Coke distribution system for our single-serve V8 beverages. Our five-year distribution agreement with Coke concluded on December 31 after both companies elected not to renew the agreement for strategic reasons. We have established a new national distributor network for immediate consumption supported by a new sales team. We started shipping in January to our new distributors who are energized and focused on driving growth. Over time, we see immediate consumption as a significant opportunity for expansion for both V8 and Bolthouse Farms. In our V8 business overall, we are seeing improved trends in our V8 100% vegetable juice and continued growth in V8 V-Fusion + Energy.

In Australia, we brought in new leadership, developed a more focused plan for our core biscuit business and implemented initiatives to drive productivity in that market. Restoring growth in this important business is a work in progress that will take time.

The third factor we cited was frontloaded marketing to support new products. We told you in the first quarter that our advertising and consumer spend increased 14% to support new products like Campbell's Homestyle soup and Campbell's dinner sauces. In Q1, we also made our first brand-building investment behind Bolthouse Farms. We knew these upfront marketing investments would negatively impact earnings in the first quarter, but our decision has helped to accelerate these brands.

Looking at our marketing spend in the second quarter, advertising and consumer promotion for the total Company increased 3%, including acquisitions. We are delivering solid performance in Campbell's Skillet Sauces and Slow Cooker Sauces. Our dinner sauces are delivering incremental sales in this new category. They are steadily building trial with very good repeat purchase rates in consumer groups, including both younger and more affluent consumers.

Campbell's Homestyle ready-to-serve soup continues to expand distribution and improve velocity. Homestyle was introduced following the discontinuation of 100% natural RTS. This transition narrowed our shelf presence because Homestyle was launched with fewer items. Going forward, we expect to gain back shelf space as we build out the line and introduce new products in the back half.

The marketing investments behind Bolthouse Farms are raising consumer awareness of this wonderful brand as we aim to expand its position in the $12 billion package fresh category. We were pleased with Bolthouse Farms' solid performance in the second quarter across all of its segments.

The final driver we discussed in November was the voluntary recall of some Plum Organics products. In the first quarter, the Company recognized $16 million in costs associated with the recall. We moved quickly in the second quarter to address the manufacturing defect that led to that recall. The acquisition of Plum, which we completed last June, contributed half of our 16% growth in US sauces in the second quarter. We believe that Plum, which we will continue to integrate, is well-positioned for a more significant sales contribution in the second half.

So, to briefly summarize, the first-quarter inventory headwind reversed much as we anticipated. The Plum recall is behind us. We feel good that we will obtain a return on the stepped-up advertising. Our core business, however, remains a bit behind our expectation through the first half of the year for the reasons I just enumerated.

So looking at the first half, it was a tale of two cities. We got off to a slow start, but recovered in the second quarter as we said we would. In the first half, net sales from continuing operations increased 2%, adjusted EBIT declined 5% and adjusted EPS decreased 4%. While we made substantial progress in the second quarter, we didn't expect to make up all the growth that we lost in the first quarter. We recognize that we must deliver strong results in the second half to achieve our full-year guidance. In the second half, we expect to grow organic sales by around 2% and acquisitions should contribute about 3% to our sales growth. For the full year, the extra week in the fiscal year will largely be offset by currency.

So how are we going to deliver this growth? Let me start by giving some highlights of our plans in US soup and Simple Meals. We expect US soup to deliver modest growth in the second half of the year. We have a strong promotional calendar in the third quarter and marketing in place to drive soup consumption in the back half of the year. We also expect our US soup business to benefit from eight new soups that we launched in January under an accelerated timeframe. These include our first Latin-inspired cooking soups, new pub-inspired varieties of Campbell's Chunky soup and new Healthy Request varieties. By comparison, we didn't launch any new soups in the second half last year.

In broth, we expect to drive continued growth in Swanson with strong Easter programs. Importantly, we expect other businesses to contribute more significantly to growth in the second half while soup does its part. In Simple Meals, we will continue to build momentum in Campbell dinner sauces. We have already created separate shelf sections for this new category in approximately 50% of the ACV. We aim to drive continued growth in Prego with more advertising in new products, including expanded presence in white sauces, a space we weren't competing in a year ago. And we expect Plum Organics to show improvement from the first half with the full product range back in supply, expanded distribution and several new products.

In Global Baking and Snacking, we expect Pepperidge Farm to deliver stronger growth in snacks in the second half. We have plans to drive Goldfish with aggressive promotional activity, increase customer-supported merchandising and accelerated channel expansion. Pepperidge Farm will increase innovation with new varieties and packs of Goldfish, the national rollout of Goldfish mac & cheese and further expansion of Goldfish Puffs. We will continue to expand Dessert Shop cookies with new varieties and we will launch Coffee Shop cookies indulgent morning offerings.

Internationally, we expect to deliver double-digit growth in sweet biscuits in Indonesia and we are focused on marketing Tim-Tam, Shapes and Arnott's sweet biscuits in Australia with increased advertising and consumer promotion and strong customer programs.

After delivering solid second-quarter results, we expect a strong second half from Bolthouse Farms. We have one of the most exciting spring innovation lineups in Bolthouse's history with marketing support and plans to launch a number of new beverages and delicious salad dressings. Although US Beverages won't be a growth engine, we do expect to see improved sales in immediate consumption channels over time as we fully develop our new national distributor network, which has been established and is operative. We are also expanding V8 V-Fusion Refreshers and we expect continued growth in energy drinks, which are performing very well.

Across our portfolio, we will be intensely focused on driving productivity and managing expense in our global supply chain. We expect to deliver improved gross margin trends in the second half and Craig will discuss why we expect profits to be better. For the full year, we continue to expect to deliver net sales growth of 4% to 5%, adjusted EBIT growth of 4% to 6% and adjusted EPS growth of 2% to 4%. We know it will require strong execution against the drivers of demand. We know it will demand operating discipline and we know that we have -- that we must have a resolute focus on accelerating stronger profitable growth across our core business while we continue to integrate our acquisitions. We don't expect to get everything back in the third quarter. It will take a strong fourth-quarter performance as well.

We are in the midst of a turbulent period. Retailers are wrestling with challenged consumers who remain under pressure and consumer behavior is becoming less predictable. We believe the weakness that Campbell and other food companies experienced in January was partially related to the extreme weather conditions, which dealt a blow to the US economy. We expect to be competing in a more typical environment over the remainder of the year. Obviously, if the environment is significantly worse than we expect, then it will be tougher to reach our guidance. In summary, we are optimistic about our plans for the second half of the year and believe that with solid execution our full-year guidance is both reasonable and attainable.

Before I turn the call over to Craig Owens, I also want to thank him for his contribution to Campbell over the past five years. As we recently announced, Craig will retire from Campbell on May 1. This will be his last earnings call with us and Craig has done an outstanding job as our CFO and Chief Administrative Officer. With his integrity, insights and expertise, he has earned the admiration and trust of our leadership team and the investment community. He will be greatly missed by all. Now, it is my pleasure to turn the call over to Craig.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Well, thanks, Denise. It has really been my pleasure to work with Campbell's and to be a part of your management team. I feel really good about where Campbell's is and where it is going and I am particularly happy that Anthony is going to be our next CFO. But I am not quite done yet, so let's get back to work. Let me walk through the second-quarter results, segment highlights and then a brief outlook with respect to our earnings guidance.

As Jennifer mentioned, my discussion of results will exclude the impact of restructuring charges in both the current and prior-year quarters, as well as the acquisition transaction costs in the prior year. I will also exclude a loss on foreign exchange forward contracts and a tax expense related to the sale of our European business that were both recorded in continuing operations in the first quarter.

On October 28, 2013, which was the first day of our second quarter, the Company completed the divestiture of our Simple Meals business in Europe. This business is reported in discontinued operations. In the quarter, the Company recognized a net gain of $90 million after tax, or $0.28 per share, from that sale. So for continuing operations, we reported second-quarter net sales of $2.3 billion, a 6% increase from the prior year. These results include a 5-point contribution from our Kelsen and Plum Organics acquisitions. Excluding acquisitions, as well as the negative impact of currency, organic net sales increased by 3% primarily driven by gains in US Simple Meals. Organic sales also rose in our Global Baking and Snacking, Bolthouse and Foodservice and International Simple Meals and Beverage segments while the US Beverage sales declined for the quarter.

Adjusted EBIT increased 15% to $374 million, which includes a 3-point contribution from the Kelsen and Plum acquisitions. The balance of the increase was driven by lower administrative expense, higher organic sales and lower marketing expense partly offset by a lower gross margin percentage. Adjusted earnings per share were $0.76, a 19% increase versus the prior year, driven by the EBIT increase and also benefiting from a favorable tax rate.

Slide 24 shows the composition of the 6% sales growth. The organic sales increase of 3 points reflects 2 points of favorable volume and mix and 2 points of growth from higher selling expense partly offset by 1 point of increased promotional spending. Unfavorable currency had a 2-point impact due to the Australian and Canadian dollar weakening against the US dollar. The favorable volume mix is driven by our US Simple Meals segment. The pricing gains were primarily related to the list price increase on US condensed soup and price increases on our baking and snacking segment. These increases were partly offset by pricing declines in Mexico based on the new distribution model. The promotional spending variance was primarily related to higher rates of spending in Global Baking and Snacking and in US Simple Meals.

Our adjusted gross margin percentage declined by 140 basis points to 35.7%. The decline in gross margin was primarily due to cost inflation, supply chain-related costs, including project expenses, weather-related costs and higher warehousing and transportation expense and unfavorable mix partly offset by productivity improvements and higher selling prices. The rate increase in cost of goods sold was approximately 5% in the quarter, including 2 to 3 points from inflation and the balance from the supply chain costs that I cited above. This increase was partly offset by productivity savings. The increase in the cost of goods sold rate for the year is now estimated at 3% to 4% with inflation and materials, energy and labor at around 2% to 3% and our expectation for productivity gains remains at approximately 3%.

Marketing and selling expense for the quarter decreased by $7 million to $268 million. The decrease was primarily due to lower marketing overhead expense, lower advertising and consumer and promotional expenses and reduced selling expense to the negative impact of currency partly offset by the addition of Kelsen and Plum Organics. Excluding acquisitions, A&C for the quarter fell by 7% and is up 2% year to date as we frontloaded marketing to support new product launches. Administrative expense decreased $21 million to $142 million primarily due to lower incentive compensation cost, lower pension expense and cost savings from recent restructuring initiatives partly offset by the impact of acquisitions, which added approximately $7 million.

For the quarter, net interest expense decreased by $2 million to $29 million. The adjusted tax rate for the quarter was 31%, a 170 basis point decrease versus the prior year. This was primarily due to lower taxes on foreign earnings in the current quarter. Adjusted earnings from continuing operations increased 19% to $240 million. The share count was unchanged versus the prior year.

Second-quarter segment sales results and the corresponding organic growth rates are shown on slide 27. Our US Simple Meals segment delivered $894 million in sales, including a $17 million contribution from the acquisition of Plum. US Simple Meals organic sales increased by 5%. Within the segment, US soup sales also increased by 5% benefiting from the movements in retailer inventory levels. As we reported with our Q1 results, retailers entered the second quarter with lower inventories than prior year. They exited the quarter with inventories somewhat higher than prior year. Consumer takeaway in measured channels was down 1% for the quarter.

Excluding the impact of the Plum acquisition, US sauce sales increased by 8%. The increase was driven by gains in Prego pasta sauce, including its new white sauces, the new Campbell's Slow Cooker Sauce and Campbell's Skillet Sauces. Our Global Baking and Snacking segment delivered $639 million in sales, including a $92 million contribution from Kelsen. Organic sales increased 2% versus the prior year with growth in Pepperidge Farm in Indonesia partly offset by declines in Arnott's in Australia. The sales gains in Pepperidge Farm reflected growth across fresh bakery and snacks. In the bakery business, sandwich bread and rolls posted strong gains even as Hostess Brands have been reintroduced into the market. Sales of stuffing also increased for the quarter partially due to the timing of the Thanksgiving holiday. The snacks business had another quarter of growth with increases in Goldfish snack crackers and Pepperidge Farm cookies partly offset by declines in adult cracker varieties. Sales at Arnott's decreased due to declines in Australia in both chocolate and savory varieties partly offset by strong growth in Indonesia.

Our Bolthouse Farms and foodservice segment posted a $359 million sales number, an increase of 2%. Sales rose 6% at Bolthouse driven by double-digit growth in premium refrigerated beverages and salad dressings and single-digit growth in the carrot business. Sales declined in the North America foodservice subsegment, principally in soup. For the first half, Bolthouse generated $392 million in sales. International Simple Meals and Beverages delivered $213 million in sales for the quarter. Organic sales increased by 1%. Sales gains in the Asia-Pacific region were partly offset by declines in Latin America. Sales in Canada were comparable to a year ago as gains in snacks and soups were offset by declines in beverages.

The sales decline in Latin America was due to the lower selling price associated with the implementation of the new business model in Mexico. Sales in Asia-Pacific increased due to gains in Malaysia and Japan.

US Beverage sales declined by 3% to $176 million. The decrease in sales was driven by declines across the portfolio primarily due to the impact of the transition to a new distribution network in single-serve immediate consumption channels. In take-home channels, we saw positive trends for V8 Red and for Splash beverages.

Operating earnings for the US Simple Meals segment increased 12% to $214 million. Operating earnings increased primarily due to productivity improvements, higher selling prices and lower marketing expense partly offset by cost inflation and supply chain-related cost. Operating earnings for Global Baking and Snacking increased 19% to $88 million. The increase was primarily driven by the acquisition of Kelsen, higher selling prices and productivity improvements partially offset by cost inflation and higher promotional spending. The operating expense increase reflected Kelsen's operating results and growth in Pepperidge Farm partly offset by lower earnings in Arnott's. Kelsen's popularity during the holiday season in Asia skews its profitability heavily to the second quarter.

Within International Simple Meals and Beverages, operating earnings were $38 million, an increase of 15%. The increase in operating earnings was primarily due to higher volume, lower selling and administrative cost and productivity improvements partially offset by lower selling prices and the unfavorable impact of currency. Operating earnings within Bolthouse and Foodservice rose by 20% to $36 million primarily due to reduced administrative expense and productivity improvements partially offset by cost inflation. For the first half, Bolthouse Farms generated $32 million in EBIT. Operating earnings for US Beverages decreased by 16% to $31 million. The decrease in operating earnings was primarily driven by cost of goods.

On slide 30, you can see US soup sales increased 5% led by broth. As expected, the year's program timing and the late Thanksgiving holiday had a very positive impact on second-quarter sales. Sales of condensed soup increased 4% driven by double-digit gains in cooking varieties. Sales of eating varieties were comparable to the year-ago quarter. Higher net pricing was partially offset by lower volumes. Ready-to-serve soup sales were comparable to a year ago as gains in Chunky and Homestyle canned soups were offset by declines in microwavable soup varieties. Broth sales increased by 21% driven by double-digit volume gains in aseptic and canned broth. US soup sales for the first half decreased by 1%. The decrease was due to a 5% decline in ready-to-serve soup and a 1% decrease in condensed soup. Broth increased by 10% for the half.

On slide 31, we look at the US wet soup category for the 52 weeks ended January 26, 2014 and in our share performance. The category as a whole rose 1.6%. Our sales in measured channels rose 1.9% with gains driven by ready-to-serve soup and broth. Condensed soup sales were comparable to the prior year. Campbell had a 59.4% market share, an increase of 20 basis points for the year. All other branded players collectively had a share of 28% and private label was at 13%. These figures were sourced from Symphony IRI multi-outlet data and are based on dollar sales.

Our second-quarter results represent a sharp improvement from the first quarter. Our position at the end of the first have is entirely consistent with the guidance expectation we set when we reported the first quarter. For the first half, net sales from continuing operations were $4.4 billion, a 2% increase from the prior year. These results include a 4-point contribution from acquisitions, which consists of Plum Organics, at Kelsen, which was acquired on August 8 and one additional week of results from Bolthouse Farms, which was acquired one week into the first quarter a year ago.

Excluding acquisitions and the negative impact of currency, organic net sales decreased by 1% driven by declines in US Beverages -- in US Simple Meals and Beverages partly -- sorry -- in International Simple Meals and Beverages partly offset by gains in Global Baking and Snacking. Organic sales were comparable to the prior year in our US Simple Meal and Bolthouse and Foodservice segments. Adjusted EBIT decreased 5% to $711 million primarily due to a lower gross margin percentage, lower organic sales and expenses related to the Plum Organics recall partly offset by lower administrative expense. Adjusted earnings per share were $1.42, a 4% decrease versus the prior year, driven by the EBIT decline partly offset by the lower adjusted tax rate. The composition of the 2% sales increase includes an organic sales decrease of 1 point, unfavorable currency of 2 points and an acquisition contribution of 4 points. The detail doesn't add because of rounding.

Our adjusted gross margin percentage declined by 180 basis points to 35.8%. The decline in gross margin was primarily attributable to cost inflation and supply chain-related cost, the impact of acquisitions and the Plum recall partly offset by productivity improvements. Marketing and selling expenses increased $18 million to $529 million. The increase was primarily driven by the addition of acquisitions and higher advertising and consumer promotion expense partly offset by the impact of currency and lower marketing overhead expense. Administrative expenses decreased $28 million to $290 million primarily due to lower incentive compensation cost, lower pension expense and cost savings from recent restructuring initiatives partly offset by the impact of acquisitions, which added about $10 million.

For the first half, net interest expense decreased by $5 million to $59 million. The decrease was primarily due to lower average interest rates on our total debt portfolio and benefits from the proceeds from the sale of our European Simple Meal business partly offset by debt incurred to fund the Kelsen and Plum acquisitions. The adjusted tax rate for the first half was 31.6%, a 70 basis point decrease versus the prior year primarily due to lower taxes on foreign earnings in 2014. This was partially offset by a favorable settlement of a state tax matter in 2013. Adjusted earnings from continuing operations decreased by 4% to $449 million and adjusted earnings per share from continuing ops decreased to $1.42 for the first half.

Cash flow from operations was $363 million compared with $499 million in the prior year. The decline was primarily due to taxes paid on the divestiture of the European Simple Meal business and lower cash earnings in fiscal 2014. Capital expenditure of $127 million rose from $110 million a year ago. We are still expecting capital expenditures for the year to be about $350 million.

As we previously announced, we suspended the strategic share repurchase program at the end of fiscal 2012 in order to reduce debt incurred to finance the Bolthouse acquisition. However, we will continue to repurchase shares sufficient to offset dilution from equity compensation programs. Net debt has decreased by $107 million to $3.9 billion.

Results from the European Simple Meals business are reported as discontinued operations. The Company completed the divestiture of its European Simple Meal business to CVC Capital Partners on October 28. In the second quarter, the Company recognized a net gain of $90 million after tax, or $0.28 per share, for the sale. For the first half, the net earnings from discontinued operations were $81 million, or $0.26 per share.

Campbell reiterated our annual guidance this morning. We expect continuing operations to grow sales by 4% to 5%, adjusted EBIT by 4% to 6% and adjusted EPS by 2% to 4%. As a reminder, fiscal 2014 is comprised of 53 weeks, one additional week compared to the prior year, the benefit of which is expected to be mostly offset by the impact of currency translation. The contribution to sales from acquisitions is anticipated to be nearly $300 million. As we have said before, in connection with the new business model in Mexico, reported sales and cost of products sold will be reduced by approximately $35 million. Interest expense is estimated at about $120 million for the year and the tax rate is projected to be between 31% and 32%. EPS growth reflects the impact of a significant increase in the tax rate versus an unusually low rate for the last year. Thank you. And with that, I will turn it back to Jennifer.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Thanks, Craig. At this time, we will conduct a Q&A session. We'd like to request that our callers limit themselves to a single question so we can respond to more people who are on the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Andrew Lazar, Barclays.

Andrew Lazar - *Barclays Capital - Analyst*

Good morning, everyone.

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

Good morning, Andrew.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Good morning, Andrew.

Andrew Lazar - *Barclays Capital - Analyst*

Denise, I was hoping to get just a little more perspective from you on -- I think you had said that sort of the consumption around core US soup or the lift basically that you are expecting from some of the activities you did in the quarter didn't really have the anticipated effect. Is your sense that that was just all sort of some of the rough weather we have been having or were there some other aspects to that that played into it?

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

Well, last year's weather contributed to the 5% growth, but we think it drove less than half of those gains. We believe that our improved execution and more effective marketing and the introduction of new products were the key drivers last year. This year, we were really satisfied with our holiday consumption, but January we did get lifts on our promotion, but they weren't quite what we expected and basically we have to do a better job in the second half driving consumption.

Andrew Lazar - *Barclays Capital - Analyst*

So you think the consumption on -- or the lifts that weren't right where you wanted them was primarily just the weather we had more recently or when you say you didn't do a good enough job, I'm just trying to get a sense of what didn't go as planned or where the improvements will come from.

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

Yes, I mean we've assessed the weather as neutral to us in this quarter. We definitely acknowledge a benefit of cold temperatures, but we think it was offset by unfavorable weather disruptions. We had plant closures for a while, retail store closures and some lost business in the foodservice sector.

Andrew Lazar - *Barclays Capital - Analyst*

Okay, thanks for the color.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question.

Operator

Eric Katzman, Deutsche Bank.

Eric Katzman - *Deutsche Bank - Analyst*

Good morning.

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

Good morning.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Good morning.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Hey, Eric.

Eric Katzman - *Deutsche Bank - Analyst*

Craig, I don't know if you are going to be down at CAGNY, but it's been a pleasure working with you. Best of luck.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Thank you. I will be at CAGNY.

Eric Katzman - *Deutsche Bank - Analyst*

Okay, all right. Then I will save the party until next week. I guess maybe kind of following up on Andrew's question a bit, I guess a couple of points around soup. One is, if -- how do we judge like the broth sales being so strong versus arguably the soup side of it a bit weaker and like how is it that one could be so strong and the other not in the same type of environment? And then two, you brought forward new product soup sales from I think what you were going to introduce them next season into this season after the fiscal first quarter and I just find that to be kind of unusual to the extent that the soup category shelf sets, etc. are normally set quite early. And so I'm kind of wondering how effective can new products be introduced in the heart of the season when the retailers are kind of normally setting it up way ahead of time?

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

Okay, I will answer both. First of all, on the broth business, we were very pleased with our performance on broth and we attribute it to a number of factors. First of all, starting with the consumer, we have seen an increase in homemade soup behavior. People are making more soup at home and they are cooking more with broth, which is great. We do think that that is partially driven by some of the innovation we have brought to the broth segment of the soup category with new flavor-infused varieties and we have also changed our advertising campaign to really emphasize insights on why I cook. And we think the combination of all of those have really helped the business. And as I said, we had a strong holiday.

In regards to the new offcycle products, our retailers are looking for growth and fortunately, we now have a pipeline with more products ready to go to market. So we view this as positive because we are doing something different and continuing to increase our news surrounding soup.

Eric Katzman - *Deutsche Bank - Analyst*

Okay. I'll pass it on. Thank you.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question please.

Operator

Jason English, Goldman Sachs.

Jason English - *Goldman Sachs - Analyst*

Hey, good morning, folks.

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

Hi, Jason.

Jason English - *Goldman Sachs - Analyst*

So I wanted to ask some questions on the beverage side of your portfolio. I apologize if I missed this in the prepared remarks, but can you elaborate more on your new route to market for immediate consumption channels with V8 and also give us an update on the similar initiative that I think you have going on with Bolthouse to try to push into those channels?

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

Okay. We have had, for the last five years, a contract with Coca-Cola for immediate consumption distribution of V8 and that ended on December 31. Over the last year of that contract, we have continued to work with Coke and effective January 1, we were able to ship V8 products to a new network of distributors for national distribution. In addition, we are now out working with predominantly convenience store customers to make sure that we not only secure the V8 distribution that we had, but expand it. We now have the benefit of going to market with both V8 and Bolthouse Farms, which gives us in total -- that is just all retail channels -- about $1 billion of healthy beverage business. So we feel like we have got a great program going forward on immediate consumption. It is a large part of other beverage companies' sales and profits and it is a very small part of ours. So we see this as a really great opportunity for us.

Jason English - *Goldman Sachs - Analyst*

Okay. Sticking on beverages, given your relationship with Green Mountain on the soup initiative, I'm curious if you can comment on your intent to put either V8 or Bolthouse Farms into its new cold beverage platform.

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

We continue to work with Green Mountain on the development of the new fresh brewed soup K-cup product and we do not have plans at this point for a V8 or Bolthouse Farms execution.

Jason English - *Goldman Sachs - Analyst*

Great. Thank you, guys.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question.

Operator

Chris Growe, Stifel.

Chris Growe - *Stifel Nicolaus - Analyst*

Hi, good morning.

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

Good morning, Chris.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Hi, Chris.

Chris Growe - *Stifel Nicolaus - Analyst*

I look forward to seeing you at the CAGNY and just a quick question for you, if I could, to understand the second-quarter benefit you received from inventory. Really what I'm trying to get to is it sounds like inventory levels need to come down a little bit in the second half of the year. So did you quantify or can you quantify sort of the benefit to Q2, maybe what you believe would have come out in the second half of the year?

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Well, the benefit to Q2, I mean I would look at that as the difference between consumption, which was down 1 and inventory, which was up 5 less some of the low level that we entered the quarter with. It's hard to quantify looking forward. Remember that inventories are moving in sort of a big bell curve through the season anyway, so when we talk about inventory movement, we are talking about difference to prior year at the beginning and end of the quarter. But they are always coming down in the second quarter and they will be coming down in the third quarter. It depends on where we end.

I think it is fair to say we need to get good consumption and good execution in the third quarter and get the inventory overhang that is out there consumed as we move through the quarter and that is why I mean we feel pretty good about that. As Denise referenced, we've got a lot of programming in the quarter and we are looking forward to seeing that work for us.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

And it's more about program frequency than program depth too.

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

Right, right. I just mentioned it.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question. Sorry, did you want to (inaudible), Chris?

Chris Growe - *Stifel Nicolaus - Analyst*

Well, that's okay. Thank you. I will leave it there.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Thanks, Chris.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question.

Operator

Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Hi, thank you. I don't claim to be the best modeler in the world, but my SG&A modeling has obviously gotten worse and worse here with Campbell and I want to know if you could help me here. Your admin costs are well below what I thought and well below a year ago. I know you have had some restructuring, but do you think your admin costs are going to be down year-over-year? And then also, Craig, on the gross margin, I think last quarter you said you expect it to be slightly higher versus year ago. You seem to be kind of angling it lower now. How much of a headwind on gross margin should we expect for the year?

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

So SG&A first. I think we would expect SG&A to be down versus prior year. We are benefiting from the restructuring activities that we pursued. You will continue to see benefit from that. You will see benefit from that in the second half. Pension cost is a positive for us this year and we have also -- it looks like we are headed for a little bit lower incentive compensation cost. So all those things will run favorably and look like they will help us in the second half too.

Gross margin has been negatively impacted in the first quarter -- well, actually, really in the first half, but particularly in the second quarter. We've had -- in the first quarter, we had the Plum recall and in the half, we've had some project expense work that has fallen into cost of sales, maybe a little bit higher than what we originally anticipated. We have had some weather-related costs. The weather has been so severe, we've actually had soup freeze in some of our transportation and have to be destroyed and that sort of thing. So we've had some kind of one-off impacts in cost of sales in the first half. As a look toward the second half, I'll try this again, I think our gross margin will be pretty similar to what it was last year, but clearly we won't recapture everything that we've lost in the first half.

Robert Moskow - *Credit Suisse - Analyst*

And consumer marketing, did your budget for that change at all first half -- are you going to be flat this year? Where are you going to be?

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

For the full year, I would expect us --.

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

We will be a little bit below the sales growth.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Yes.

Robert Moskow - *Credit Suisse - Analyst*

So did that change during the course of the year or is that --?

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

Yes, we had expected to be a little bit above the rate of sales and now we are forecasting to be a little bit below.

Robert Moskow - *Credit Suisse - Analyst*

Okay, thank you.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

You're welcome. Thanks, Rob. Next question please.

Operator

Bryan Spillane, Bank of America.

Bryan Spillane - *Bank of America Merrill Lynch - Analyst*

Hi, good morning.

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

Good morning, Bryan.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Hi, Bryan.

Bryan Spillane - *Bank of America Merrill Lynch - Analyst*

Just first question, I just wanted to follow-up I guess on Rob's question. If you kind of back of the envelope math, you need to grow operating -- to get to the low end of the guidance, operating income has to grow by about $90 million in the second half of the year and just how much of that is sales-dependent and how much of it is going to be sort of more dependent upon some of the cost phasing and some of the lower costs in the second half? I am just trying to tease out sort of how much of the profit growth is really just purely sales-dependent and how much is going to be year-on-year comps or other programmatic savings?

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

Yes, we looked at this --

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Go ahead, Anthony.

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

-- pretty closely and actually only a small part of it derives from the organic sales growth. A big portion is in the G&A line related to the items that Craig just talked about. And also, don't forget the 53rd week has a significant impact in the fourth quarter as well.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Having said that, as Denise said, I mean we do need better sales performance in the second half than we had in the first half given the weak first quarter.

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

Right. And we expect organic sales up 2% and 3% from acquisitions.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Don't forget that you've got a 53rd week and the acquisition contribution in the back half.

Bryan Spillane - *Bank of America Merrill Lynch - Analyst*

Okay, but that [optic] of having such a big profit ramp in the back half doesn't look as challenging as it does when you sort of factor in some of the cost comparisons or some of the other factors in the second half?

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Exactly. When you take it apart, it doesn't have to be driven by really extraordinary sales results or anything. Right.

Bryan Spillane - *Bank of America Merrill Lynch - Analyst*

Okay. And then also just to follow up on Jason's question relative to the distribution changeover at V8, has that started yet and will there be any -- do you expect to see any sort of impact on sales in terms of just maybe pipeline fill and subsequently, have you seen any sort of change as inventories maybe bled down? Just trying to understand if there is any lumpiness in that that we should expect going forward.

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

Yes, it is in effect, effective January 1 and we did see a wind-down in sales to Coke in the second quarter. We will be and are shipping now to the new distribution network. We believe that there will be pipeline fill and increased sales over time. So that is probably the best I can do at this point.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

The ramp up probably won't be quite as dramatic because it is across a large number of distributors that will be coming on as we move through the quarter.

Bryan Spillane - *Bank of America Merrill Lynch - Analyst*

And the distribution, the distributors, are they beverage distributors or are they sort of more general merchandise distributors? Trying to understand who the -- what the --.

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

They are distributors that cater to the immediate consumption channels, largely convenience stores and single-serve products.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

So it is multiple line distributors (multiple speakers).

Bryan Spillane - *Bank of America Merrill Lynch - Analyst*

Got it. Okay, great. Okay, thank you very much. Look forward to seeing you guys next week.

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

You are welcome.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question, please.

Operator

Diane Geissler, Credit Agricole.

Diane Geissler - *CLSA Limited - Analyst*

Good morning.

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

Hi, Diane.

Diane Geissler - *CLSA Limited - Analyst*

I just wanted to ask, because a couple of your peers have talked about spending cuts under the SNAP Program and the headwind to sales, and I just was wondering do you have any way to quantify what that might mean for Campbell across the pieces of your portfolio that are attractive to those consumers?

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

I think it's very difficult for us to quantify. I would sort of put it into the larger basket of consumer headwind issues that are out there. I mean I think you have seen us and our peers under a lot of pressure to get volume growth. You have seen the grocers under pressure to get volume growth. So I think it is part of what is playing in. I think it is really difficult to segregate out that specific impact.

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

Yes, they are dealing with lower employment, higher payroll taxes, healthcare changes, lower discretionary spending available on food. So the food stamps is part of all of that.

Diane Geissler - *CLSA Limited - Analyst*

Okay, I appreciate the color there. And then just a follow-up on the beverage Coke distribution. Was there anything in that contract that prevented you from having product in competing categories? I guess what I am asking is now that you have a different distribution network, are there categories that would be available for you to expand into that perhaps before you weren't allowed in?

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

Yes, at this point, we are focused on expanding the beverage because that is a huge opportunity for us.

Diane Geissler - *CLSA Limited - Analyst*

I take it there weren't any contractual limitations?

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

As we look ahead, the new distribution model does provide us some opportunities to expand beyond the beverage category into some of our other Simple Meal categories as we push it into immediate consumption channels.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

And it also gives us the opportunity to -- while the route to market is a little bit different because it is a chilled route to market for Bolthouse and it is shelf-stable, even though it is going into refrigerated spaces for V8, it gives us an opportunity to go to distributors and to go to retailers on a joint basis now that we didn't really have under the Coke agreement.

Diane Geissler - *CLSA Limited - Analyst*

Okay, great. Thank you.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Thanks, Diane. Next question.

Operator

Akshay Jagdale, KeyBanc.

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

Hi, Akshay.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Hi, good morning. Just wanted to ask about marketing in light of the lower spending that you are expecting now. It is specific to Bolthouse. I know you've spent some money on that brand and I think that was the first initiative behind that brand period. So can you just give us a sense, just an update on Bolthouse, what returns you are sort of seeing from these early investments you made, what does that imply for long-term sort of growth trajectory of that business? And then if you could just comment on which brands or categories may -- are the ones where you are cutting the marketing, that would be helpful. Thank you.

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

In terms of Bolthouse Farms, recall this is the first marketing effort that we've had on this brand since it has been newly acquired and the marketing largely met our expectations. We were actually very pleased with the results and we will continue to market that brand in the second half of this year and invest in it going forward.

In terms of the other categories, we've been focusing our marketing largely at competitive levels on our core brands and at ramped-up levels on our new products such as the Campbell's cooking sauces and Homestyle and Prego. The only place I can tell you that we will course-correct going forward as we believe we did not spend at the appropriate level on condensed eating soup and we will be course-correcting that going forward.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

And in terms of where the reductions are, I think Beverages will be a little bit lower than our original thinking there as we shift some of that probably to more trade-related activity. And as we continue to work our way through some of the headwinds that we've seen in Beverage and maybe a little bit lighter in Pepperidge, but we are not going to be very different from the shape of our original expectation. It was always heavily frontloaded to support the new product introductions and to do the first advertising around Bolthouse and it was always intended to taper back closer to prior year or slightly below for the balance of the year.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

And just long-term implications of whatever you learned from the advertising dollars you've spent on Bolthouse? I mean can you at least share sort of what you learned from the marketing initiatives that you took on Bolthouse? Thank you. I'll pass it on.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

I think it is probably a little early to give the full readout from that, but I would fully anticipate that we will continue to be more active in terms of brand-building around Bolthouse than they have been historically there. I mean we really think that is one of the opportunities that we have looking forward with the brand.

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

We will take a note to make that part of our review at Analyst Day in July.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Thank you. I'll pass it on.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question please.

Operator

David Driscoll, Citi Research.

David Driscoll - *Citigroup - Analyst*

Thank you and good morning.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Hi, David.

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

Good morning, David.

David Driscoll - *Citigroup - Analyst*

I want to go back on soup for just a minute, an important question here. We've done some analysis on kind of the multiyear trends. Third quarter of last year was absolutely a superstar quarter for consumption within our Nielsen data. Your results as well. So Denise, how do you think about this expectation that second-quarter consumption kind of underperforms, but yet the requirement is for third quarter to be a strong one, yet it faces singularly the most difficult comparison that you have faced in quite a number of years?

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

I mean we acknowledged the fact that we did have a very good third quarter last year. But we feel as we look at our plans in the back half that they are robust and we are doing some things over the top of what we did last year to have a different outcome. So we have greater promotional frequency. We are launching eight new soups, including our first Hispanic cooking soups. We are expanding pub-inspired Chunky soups, which are doing really, really well. Some of those are in the top-selling SKUs of all soup and we are building more momentum on broth with a bigger Easter program. So we believe that we have robust plans and we are planning on cycling quarter three and quarter four with positive momentum on soup.

David Driscoll - *Citigroup - Analyst*

I appreciate the answer. Thank you.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

You are welcome. Next question, please.

Operator

Alexia Howard, Bernstein.

Alexia Howard - *Sanford Bernstein - Analyst*

Good morning, everyone.

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

Hi, Alexia.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Hi, Alexia.

Alexia Howard - *Sanford Bernstein - Analyst*

Hi, can I ask about the outlook on the commodity cost side? There seem to be a lot of moving pieces there. On the one hand, the grain envelope is down, which might help the Pepperidge Farm business. On the other hand, we have got droughts in California and meat pressures kicking in as well. As you look out through the second half of the year, is some of your -- is the commodity outlook pretty benign at this point? Is that one of the reasons why the profit growth should start to accelerate in the second half? Thank you.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Yes, so in the second half, not much different on the commodity front, on the inflation rate front. We will benefit from not having, as I described earlier, some of the kind of one-off costs that we have had that have hit cost of sales in the first half, but we are still looking for an inflation rate on inputs and if you just narrow it down to materials, it is more like 1% to 2% -- 1% to 2%, 2.5%. Once you put labor in and other overhead costs in, it gets up to kind of 2% to 3%. And then in the first half, we have been impacted with kind of another point of unusual cost items.

So not much impact in the second half. As we look forward to next year, you are right; the drought in California is probably going to have an impact on our tomato and our processed tomato cost structure. You are also obviously right about grains a little bit of relief for Pepperidge going forward. But not much impact in the second half. As you know, we have got a commodity buying program that keeps us out a little bit ahead of the curve and we are pretty well locked in for the balance of this year.

Alexia Howard - *Sanford Bernstein - Analyst*

Great. Thank you very much. I will pass it on.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Thanks.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question please.

Operator

Thilo Wrede, Jefferies.

Thilo Wrede - *Jefferies & Co. - Analyst*

Good morning. You've owned Plum for three quarters now. What are your learnings on the brand and what I mean is what do you know now about the consumer that you didn't know before about the new channels that you got into with that brand? And any overlap between Plum and Bolthouse because they both cater more to millennials probably that you could exploit?

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

It's still early days of owning Plum and so far, despite the recall situation that we had, we are continuing to see the brand grow in sales. However, we've been really focused on getting back into business on that brand throughout our customer base before we start really expanding distribution and bringing out new products, which will start to happen in the second half. So it's still early days, but we are very pleased with the brand and with the business.

Thilo Wrede - *Jefferies & Co. - Analyst*

So no learnings yet that you are willing to share?

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

No, not yet. I mean other than the fact that we've studied the category before we made the acquisition and we know it is a higher growth space, which is very consistent with our strategy and it also is a very popular brand with millennials.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

I mean, I think one thing, it's a negative circumstance to have the recall. But one thing that we've seen is that Plum consumers are very loyal to the brand and I think they've really appreciated the way that we have communicated and handled that recall process. They have been very communicative through that process on social media and that sort of thing. And it has proved to be, despite the negative starting point, to be a pretty good reflection of brand loyalty.

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

Yes, they have shown us that through (inaudible) at the stores where we are fully in stock. So that is an encouraging sign.

Thilo Wrede - *Jefferies & Co. - Analyst*

Okay, thanks.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

You are welcome. Next question, please.

Operator

Matthew Grainger, Morgan Stanley.

Matthew Grainger - *Morgan Stanley - Analyst*

Hi, good morning, everyone.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Hi, Matt.

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

Hi, Matthew.

Matthew Grainger - *Morgan Stanley - Analyst*

Just two quick ones since we are in overtime here. One, I just wanted to check in on the Goldfish Puffs launch, just it's been very visible. It is had a lot of display; it seems to be well promoted. So what can you tell us at this point about trial and incrementality to sort of the overall consumption on the brand?

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

Goldfish Puffs has been one of our better introductions, and it is largely meeting our expectations. Inclusive of new products, Goldfish was up 5%. So Puffs certainly helped contribute to that sales growth.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

It has been appealing to a slightly older consumer, which we think is more incremental for us.

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

Targeted towards teens, and that seems to be a good market for us beyond kids and performing very well.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay. And are you at the point now where you have a view on repeat purchase, or still early?

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

Still early.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay. And then just quickly on the inventory, just as we're thinking through the mix implications going into next quarter, is that more concentrated in ready-to-serve? Is it sort of broadly across soup, or are there other categories implicated?

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

I would say it weights more to the ready-to-serve category.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay, great. Thanks, Anthony.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question, please.

Operator

David Palmer, RBC Capital Markets.

David Palmer - *RBC Capital Markets - Analyst*

Good morning.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Hi, David.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Hi, David.

David Palmer - *RBC Capital Markets - Analyst*

When you look back at that first half and you think about the ROI on the innovation spend that you had in the first quarter and advertising in that quarter, the promotion spending in the second quarter, how are you reviewing that as you are thinking about your tactics into the second half of the year? Will you pursue a similar strategy or perhaps adjusting that somewhat?

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

Well, obviously, on the advertising we definitely frontloaded the year. It was up 14% in the first quarter. So that will not be repeated, obviously. We expect a more normal ACT in the back half.

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

If you think about innovation against our dinner sauce, it's hard to think about that over a quarter or even a half. We are investing to create a new behavior and a new category and a new shelf space, so we are investing pretty heavily to develop that market. And we look at it more on a long-term ROIC basis.

David Palmer - *RBC Capital Markets - Analyst*

I'm just asking because it seemed like you tried -- I can appreciate the fact that you are pursuing something more incremental, something that needed a little bit more explaining in that first quarter advertising spend, but it does feel like a lot of companies that have pursued more incremental with the advertising have had disappointing returns on that. So I don't know if that is just in general an indictment on the media spend in general and how you are thinking about that going forward.

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

I think it is, again, really difficult. We are still in the trial-building phase on something like dinner sauces. The purchase cycle is fairly long, so it does take some time and some investment. So again, I think it is hard to respond to a quarter question.

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Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

We are intentionally investment spending. I mean we know -- on these new product introductions, you are not going to get the return in the quarter on the spending. So I think you have to look at it over a little bit longer period of time and see how the trial and repeat build.

David Palmer - *RBC Capital Markets - Analyst*

Thanks.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Next question.

Operator

Priya Ohri-Gupta, Barclays.

Priya Ohri-Gupta - *Barclays Capital - Analyst*

Okay, thank you so much for taking the question. I believe on the last call you had mentioned a possibility to refinance at least part of your August maturities. First, is that still the case and second, if so, how are you thinking about potentially adding change-of-control language to the future bond issuances and potentially retroactively adding in any existing bonds? Thank you.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

So it's hard for me to see much advantage to adding it retroactively to bond issuances that are out there. We will consider it going forward, but I feel -- well, it's just too early to say. Anthony will give that some consideration as we look forward to our future bond issuances.

Priya Ohri-Gupta - *Barclays Capital - Analyst*

Okay, that's very helpful. And then just a quick housekeeping. Where should we expect your debt reduction to be by the end of the year, either absolutely or in terms of your leverage?

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Well, I think if you look at the absolute numbers, once you take out sort of the noise created by the European divestiture and the purchases of Kelsen and Plum, it should be a sort of normal operating cash year for us. I mean we tend to fall somewhere between $800 million and $1 billion of operating cash flow on an annual basis.

Priya Ohri-Gupta - *Barclays Capital - Analyst*

Okay, thank you. That's helpful.

Craig Owens - *Campbell Soup Company - SVP, CFO & CAO*

Thanks.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Let's just take one last question.

Operator

John Baumgartner, Wells Fargo.

John Baumgartner - *Wells Fargo Securities - Analyst*

Thanks for the question. Denise, sorry if I missed this, but did you quantify the impact of the Skillet and Slow Cooker Sauces on the quarter?

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

I'm sorry, I couldn't quite hear that. Could you repeat that?

John Baumgartner - *Wells Fargo Securities - Analyst*

Yes. Did you quantify the impact of the Skillet and Slow Cooker Sauces this quarter in the sauces business?

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

We didn't, but we may be able to if I talk long enough. While we are looking, I will give you the replay. It is going to be available two hours after the call concludes. You will dial 703-925-2533 and the passcode is 1630990. We will have that up until February 28. Was that long enough, Anthony?

Anthony DiSilvestro - *Campbell Soup Company - SVP, Finance*

Yes, it is. Dinner sauces contributed about a point of sales growth to the US Simple Meals segment.

John Baumgartner - *Wells Fargo Securities - Analyst*

One point. And then, Denise, can you just walk there how you are seeing those aisle merchandising programs developing at retail with your customers?

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

Are you talking about on the cooking sauces?

John Baumgartner - *Wells Fargo Securities - Analyst*

Yes, just adding the square footage in the aisles.

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

Recall when we introduced Skillet Sauces last year, we had the situation where it was merchandised in about five different places in the grocery store and so we worked diligently this year for our customers to place a section of cooking sauces in the store and it varies where that is located, but typically in a sauce section or even next to broth. What it does is it gives four feet of space to ourselves and some of our competitors, but it gives the consumer a destination to know where to shop for these kinds of products. And since we are building a platform, that has been a strategic imperative.

John Baumgartner - *Wells Fargo Securities - Analyst*

Okay. But you are seeing a generally favorable buy-in with that from the retailers' perspective?

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

I think about half of them.

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

Yes, about half of them, right, exactly.

John Baumgartner - *Wells Fargo Securities - Analyst*

Okay, great. Thank you.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

You are welcome. Thanks, everybody, for joining us for our second-quarter earnings call. We appreciate your patience as we tried to clear out the queue a little bit. If you are a reporter and have questions, please call Carla Burigatto, Director of External Communications, at 856-342-3737. Investors and analysts should please call me, Jennifer Driscoll, at 856-342-6081. Have a great Valentine's Day. Hope to see you at CAGNY next week and we will conclude our program now. You may disconnect.

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 good day.
