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EDITED TRANSCRIPT

CPB - Q1 2016 Campbell Soup Co Earnings Call

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OVERVIEW:

Co. reported 1Q16 as-reported net sales of $2.2b and adjusted EPS of $0.95.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Campbell Soup first-quarter 2016 earnings call.

(Operator Instructions)

As a reminder, this conference is being recorded. I will now turn the call over to your host, Ken Gosnell, Vice President, Finance Strategy and Investor Relations at Campbell Soup. Please go ahead.

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

Thank you, Stephanie. Good morning, everyone. Welcome to the first quarter earnings call for Campbell Soup's FY16. 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. The 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 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.

As we said in this mornings news release, in FY16 the Company incurred mark-to-market losses associated with the interim re-measurement of certain US pension plans. The impact on EPS was $0.26 per share. The Company also incurred restructuring charges, implementation costs, and other related costs associated with the new organizational structure and cost savings initiatives. The impact on EPS was $0.07 per share.

Our comparisons of FY16 with FY15 will exclude these items for comparability. 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. With that, let me turn the call over to Denise.

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

Thank you, Ken. Good morning, everyone, and welcome to our first quarter earnings call. Today I'll share my perspective on the overall operating environment, the changes we've implemented at Campbell, and our first quarter business performance.

The seismic shifts that we've outlined in previous meetings continue to impact the food industry which remains under pressure from new global economic realities, major demographic shifts, changing consumer preferences for food with an emphasis on health and well-being, and the continued growth of digital marketing and e-commerce channels.

Looking at the operating environment, conditions remain challenging. In the United States, the economic situation is mixed. Unemployment continues to improve, but consumers remain very cautious. We're continuing to see Americans save more and spend less amid the uncertain economic climate.

Outside the US, we're seeing macroeconomic challenges in other markets where we have significant operations, including Canada, China and Indonesia. Generating growth in this environment has been and remains difficult. As a result, the industry continues to respond with consolidation, spin-offs, aggressive cost cutting programs, and other measures to improve operational efficiency. Meanwhile, food retailers continue to respond by reconfiguring existing stores with a focus on the perimeter, by launching new smaller formats and by investing heavily in e-commerce capabilities.

Several years ago, we recognized the early signs of many of the trends that the industry is currently facing, and we started taking steps designed to best enable Campbell to navigate the changing landscape. While we've made progress through FY15, our actions haven't been sufficient. That's why last year, we put a bolder plan in place to reshape Campbell.

We began FY16 after successfully implementing significant changes to align our enterprise structure with our strategy. We formed three new divisions with clear portfolio roles.

We began implementing a three year $250 million cost savings initiative that is delivering earlier than expected benefits. We created a new Integrated Global Services organization to provide services to our divisions more efficiently and effectively. We initiated the first phase of zero-based budgeting to instill greater cost discipline and create an ownership mindset among employees. We added another growth engine in Garden Fresh Gourmet to bolster our Campbell Fresh division, and extend our presence and scale beyond produce into the deli section of the store perimeter.

As a result of these actions, we entered FY16 better positioned to execute against our strategic imperatives. With that as context, let me turn to our first quarter results. I'm pleased with our overall performance to start the year. Organic sales in the quarter were comparable to a year ago and consistent with our expectations, given that we're cycling an increase of 5%.

I'm particularly pleased with our third consecutive quarter of adjusted gross margin expansion, and the improvements we've made in our supply chain. Importantly, we delivered strong adjusted EBIT and EPS performance.

As you saw this morning, we revised our annual guidance. Given our improved margin outlook for the year, we raised guidance for adjusted EBIT and adjusted EPS, while we lowered sales guidance to reflect increased currency headwinds.

Our new reportable segments align with our three new divisions. Anthony will discuss our revised guidance and provide a detailed review of our segment results in a moment, but I wanted to offer my perspective on several notable items within each of our three new divisions.

Let's start with our largest division, Americas Simple Meals and Beverages. As a reminder we're managing this division for moderate growth consistent with the categories in which we operate and for margin expansion. As we've discussed with you before, we're focused on increasing price realization, optimizing promotional spending, and improving our supply chain performance. While we have more work to do and its early days, I'm encouraged by the progress the Americas team has made on all three fronts.

As a result of our pricing and lower promotion activity, soup volumes declined as expected. Consumption was soft in the quarter, but this is not surprising due to the fact that our promotional activity and new advertising campaigns started later in the quarter versus prior year. In early October, we began airing our new "Made for Real, Real-Life" advertising.

Built around the strategic insights we've shared with you about the changing mosaic of the American family, this campaign represents a major departure for Campbell, and depicts how our real food fits into real peoples lives in an authentic and relatable way. Digital media is playing a larger role in this campaign than in previous efforts. Looking ahead, we expect improved sales performance in the second quarter as our marketing spending increases and the campaign gains momentum.

As we talked about in July, we're focused on fewer, bigger innovations in the Americas division. While our new Swanson bottled broth is off to a slower start than anticipated, both Campbell's Fresh-Brewed soups in K-Cups and Campbell's organic soups are meeting expectations. The highlight in this division was the significant gross margin expansion. A major improvement this quarter was our supply chain performance, as evidenced by better customer service levels.

We're cycling significant supply chain challenges, especially transportation and warehousing. We're also benefiting from the mild inflationary environment this quarter. That said, the supply chain team has driven results ahead of expectations. Overall, the new Americas Simple Meals and Beverage division is off to a promising start in delivering against its portfolio role.

Our Global Biscuits and Snacks division unifies our Pepperidge Farm, Arnott's and Kelsen businesses, and its portfolio role is to expand in developed and developing markets while improving margins. This division too is off to a promising start in fulfilling its portfolio role, with organic sales growth, improved gross margins and strong earnings.

I'm especially encouraged by our sales performance in our core markets, the US and Australia. In US biscuits and Bakery, our Pepperidge Farm brands performed very well driven by strong growth in crackers and fresh bakery, partly offset by declines in cookies. Our Goldfish business had a particularly strong quarter with double-digit sales growth.

Turning to developing markets, we drove organic sales growth in Malaysia, but we're continuing to keep a close eye on Indonesia where the challenging economic conditions we outlined in September continued to impact our business. As we stated at that time, we believe it's important for Campbell to become more geographically diverse, despite short-term economic pressure in developing markets.

Our third division is Campbell's Fresh, which includes Bolthouse Farms, Garden Fresh Gourmet and our refrigerated soup business. Here, we're focused on accelerating sales growth and expanding into new package fresh CPG categories. Reported segment sales increased 8% in the quarter. Excluding the impact of Garden Fresh Gourmet acquisition, sales declined 3%.

Let's take a closer look at what drove the decline. In Bolthouse Farms, we delivered mid single-digit sales growth in the CPG business behind premium beverages and refrigerated salad dressings, as we cycled double-digit growth in the prior year. However, these gains were more than offset by declines in our Farms business, which includes our fresh retail carrots business where we're the market leader, and our ingredients business. Sales were down in carrots, although we grew share. As a reminder, carrots are an important business in that they provide both scale in produce, and an effective refrigerated logistics system for our CPG business.

The main culprit of the sales decline was the ingredients business. As we discussed at our Investor Day in July, the carrot concentrate business began softening last year due to weak demand in Japan. That softness accelerated in the first quarter. We expect the rate of decline in ingredients to moderate, especially in the back half of the year.

While this is not the growth profile we expect from this division, we remain enthusiastic about C-Fresh and especially the CPG business. We have compelling brands, delicious products, a steady stream of on trend innovation, investments to expand juice and salad dressing capacity and a strong team leading the business. We expect sales in our package fresh CPG business to accelerate as the year progresses, driven by the continued expansion of 1915, our cold-pressed ultra-premium juice line, and the strong spring innovation suite for super premium beverages and salad dressings.

Now a word on Garden Fresh Gourmet. The integration into C-Fresh is on track and there have been no major surprises. As we outlined in July at our Investor Day meeting, we're focused on driving distribution and increasing market penetration beyond its Midwest stronghold.

Before wrapping up, I want to spend a moment on our cost savings initiative. We remain focused on transforming our cost structure, and creating an ownership mindset where employees treat every dollar as if it were their own. Our streamlined organization, our ZBB efforts, and our integrated global services organization are all having a positive impact on both our cost and our culture.

I'm very pleased with our progress in all these areas particularly in IGS. This group is key to driving cost savings and building new capabilities, but IGS is about more than efficiency and effectiveness. Beyond the cost savings and capability building underway, IGS is helping to spur significant cultural change by fundamentally altering the way work is performed at Campbell.

Looking at our three new divisions and IGS, it's still early days and we have more work ahead of us to fully unlock the potential of our redesigned enterprise structure, but we're off to a solid start. Today, we're better positioned to execute against the four strategic imperatives we outlined in July.

First, we're leveraging our purpose, Real Food that Matters for Life's Moments as a filter for strategic decisions. For example, we've made recipe changes to several of our core North America products, and we continue to engage consumers in open dialogue about the ingredients we use and the rationale behind our decisions as we strive to set the standard for transparency in the food industry.

Second, we're shifting more of our marketing budget to digital channels and remain committed to growing our e-commerce capabilities. Third, we're advancing our health and well-being imperative across our Company. Our new 1915 ultra-premium juices are meeting our expectations, and we've had other recent successes including Campbell organic soups, and the distribution of Carrots Snacks into the New York City school lunch program.

And finally, we remain focused on expanding in developing markets, particularly in Southeast Asia with an emphasis on Malaysia and Indonesia. In China, we've added resources to expand Kelsen in anticipation of a positive Chinese New Year.

In summary, these are unprecedented times of change, marked by challenging economic conditions. In the food world, consolidation and intensified competition are disrupting and altering the landscape.

At Campbell, we remain clear-eyed about our challenges, focused on the consumer, responsive to our customers, and dedicated to delivering against our purpose. I'm confident the actions we're taking will set Campbell apart from other food companies, and strengthen our growth trajectory over time.

I look forward to answering your questions, but 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 updated guidance, I wanted to give you my perspective on the quarter and outlook for the balance of the year. As Denise mentioned, organic sales were in line with our expectations after lapping a solid year ago quarter. We made good progress on gross margin which increased 260 basis points on an adjusted basis, benefiting from net price realization and supply chain performance, while cost inflation moderated.

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I'm very pleased with the progress we're making against our cost reduction initiatives, delivering $30 million of savings in the first quarter ahead of our expectations, and as I'll share later, allowing us to raise our 2016 savings target. Our improved outlook for cost inflation and additional cost savings will enable us to both fund investments in longer term innovation, and raise our full year guidance for adjusted EBIT and adjusted EPS.

And since we last updated you, we are experiencing an additional 1 point of headwind from currency translation across the P&L, as the US dollar continues to strengthen. Lastly, as we indicated on our fourth quarter call, we have changed our reporting segments to align with our three new divisions, and change our method of accounting for pension and post-retirement benefits, both of which I will cover in my comments.

I'll begin with the benefit accounting change, and then discuss our results and updated guidance. To provide greater transparency into our financial results, we are changing our method of accounting for pension and post-retirement benefits. Previously, actuarial gains and losses were deferred and amortized into earnings over several years. In our case, we had been amortizing significant actuarial losses which arose over time primarily from declining interest rates.

Under the new mark-to-market method which has been applied to all prior periods, actuarial gains and losses will be recognized immediately into earnings rather than amortized. We will identify the mark-to-market adjustment as an item impacting comparability, and exclude it from our adjusted results. Mark-to-market adjustments are recognized on re-measurement dates, typically year-end.

What's shown on this chart is the impact on our FY15 full year and first quarter adjusted results from removing the actuarial loss amortization. Recasting our full year 2015 results increases adjusted gross margin by 70 basis points, adjusted EBIT by $97 million, and adjusted EPS by $0.19.

For the first quarter of 2015, the impact is an increase of 60 basis points on gross margin, $21 million of EBIT or $0.04 per share. It is important to note that the benefit accounting change has no impact on cash flow. In the presentation of our first quarter 2016 results and guidance, all comparisons to 2015 are against this recasted 2015 adjusted base.

Unrelated to the change in benefit accounting method I just described, we are required to re-measure certain US pension plans quarterly during 2016, as a result of a program in which we offered and paid lump sums to plan participants no longer with the Company. This remeasurement led to a mark-to-market loss of $0.26 per share in the first quarter.

For the first quarter, net sales on an as-reported basis declined 2% to $2.2 billion primarily due to the negative impact of currency translation. Excluding currency and the impact of the Garden Fresh Gourmet acquisition, organic net sales were comparable to the prior year, as net price realization from both higher list prices and lower promotional spending was offset by lower volumes.

Reflecting a 440 basis point increase in margin, adjusted EBIT increased 23% to $479 million benefiting from a higher gross margin percentage, savings from our cost reduction initiative, and lower advertising, reflecting a shift in spending to later in the year.

These positive drivers were partly offset by currency translation which had a 4 point negative impact on EBIT, the equivalent of $0.03 per share. Adjusted EPS increased 22% to $0.95. Just to be clear, EPS growth on an adjusted basis is not impacted by the accounting change, but reflects the improved operating performance of the business.

Breaking down our sales performance for the quarter, reported net sales declined 2%, with organic sales comparable to the prior year. Within organic sales, volume and mix subtracted 2 points which was primarily driven by US soup within Americas Simple Meals and Beverages, and the carrots ingredients business within Campbell Fresh.

Higher selling prices in Americas Simple Meals and Beverages contributed 1 point, reflecting our pricing actions on condensed soup, Prego Pasta sauce and foodservice in the US and across the Canadian portfolio. Lower promotional spending in Global Biscuits and Snacks also added 1 point to sales growth.

Currency translation had an adverse impact of 3 points on the top line. Our two primary foreign currencies, the Australian dollar and Canadian dollar both declined against the US dollar. To complete the bridge, our most recent acquisition, Garden Fresh Gourmet contributed 1 point to net sales in the quarter.

Our adjusted gross margin percentage increased by 260 basis points to 37.9%, exceeding our expectations on lower than anticipated cost inflation, and improved supply chain performance. Within inflation and other, which negatively impacted margin by 20 basis points, cost inflation of approximately 1% was mostly offset by improved supply chain performance primarily in the areas of transportation and warehousing. Mix was slightly negative, reflecting a small negative impact from the acquisition.

In aggregate, our price realization actions contributed 1.3 points of margin expansion, with 40 basis points from reduced promotional spending, principally trade reductions in Pepperidge Farm and US soup and 90 basis points from higher selling prices. Lastly, we're off to a strong start on our supply chain productivity programs which contributed 160 basis points of margin improvement in the quarter.

Excluding items impacting comparability, marketing and selling expenses declined 15% in the quarter primarily due to lower advertising spending, savings from our cost reduction initiatives, and the impact of currency translation. The decline in advertising reflects the shift in the timing of our spending principally in US soup to later in the year. Adjusted administrative expenses decreased 8% primarily due to savings from our cost reduction program and the impact of currency translation.

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 in aggregate, adjusted EPS increased $0.17 compared with the prior year, increasing from $0.78 to $0.95 per share. On a currency neutral basis, growth in adjusted EBIT mostly from the gross margin expansion contributed $0.23 to EPS growth. The impact from share repurchases under our strategic share repurchase program reduced our share count, and added a $0.01.

Going the other way, net interest expense increased $3 million, about $0.01 per share as we extended the maturity on the debt portfolio. Our adjusted tax rate for the quarter was 34.1%, up 2.2 points versus the prior year, primarily due to our geographic mix and higher US state taxes in 2016 which negatively impacted EPS by $0.03. Currency had a $0.03 negative impact on EPS in the quarter, completing the bridge to $0.95 per share.

Beginning in 2016, we are aligning our reporting segments with our new division structure. We are now reporting our results in three segments, Americas Simple Meals and Beverages, Global Biscuits and Snacks, and Campbell Fresh.

In connection with our change in benefit accounting, we have modified our method of allocating pension and post-retirement benefit cost to the segments. In 2016, only the service costs representing the value of the retirement benefit earned in the period is allocated to segments. The other elements of expense, including interest costs on the liability, expected return on assets, and actuarial gains and losses are reflected in unallocated corporate expense.

As previously mentioned, we will identify the mark-to-market adjustments as an item impacting comparability and exclude them from our adjusted results. We have adjusted our historical results to reflect these changes, with FY15 sales, operating earnings, and margin by segment shown on this chart. Immediately following the filing of our first quarter 10-Q, we will also provide recasted historical annual and quarterly results, including quarterly results for our segments reflecting the benefit accounting changes.

Now turning to our segment results. In Americas Simple Meals and beverages, organic sales decreased 1% to $1.3 billion. US soup sales decreased 3%, reflecting declines in ready-to-serve soups and broth, partly offset by gains in condensed soup. Impacted by our list price actions and changes to our promotional programs, soup volumes, as expected, were negatively impacted.

Sales of US beverages declined slightly, primarily due to declines in V8 V-Fusion beverages, partly offset by gains in V8 Splash. Sales of other US Simple Meals increased driven by Prego pasta sauces, Campbell dinner sauces, and our new Prego and Pace ready meals. Excluding the negative impact of currency translation, sales in Canada increased, driven by gains in soup.

Operating earnings increased 19%, reflecting a higher gross margin percentage which benefited from net price realization and improved supply chain performance, particularly in the areas of transportation and warehousing, and also from lower marketing and selling expenses. Our advertising expenditures were down in the quarter, as we've shifted the timing of our activity to later in the fiscal year.

Within US soup, the 3% sales decline was driven by a 10% decline in ready-to-serve soup, and a 9% decline in Swanson broth offset by a 2% gain on condensed. Sales of our Fresh-Brewed soups for Keurig, which are not part of the wet soup category, contributed 50 basis points of growth to total US soup in the quarter.

We began and ended the quarter with retailer inventories in aggregate comparable to year ago levels. With the formation of the Americas Simple Meals and Beverages segment and our efforts to diversify the portfolio beyond soup, we do not believe sub category sales performance in soup is as meaningful a disclosure. We will continue to provide this information for the balance of the year, before discontinuing in FY17.

Here is a look at US wet soup category performance and our share results as measured by IRI. For the 52 week period ending November 1, 2015, the category as a whole declined 1.3%. Our sales in measured channels declined 1.7%, with weakness in ready-to-serve and condensed soups partly offset by strength in broth.

Campbell's had a 59% market share, a decline of 20 basis points. Private label grew share by 20 basis points, finishing at 13%. All other branded players collectively had a share of 28%, unchanged versus the prior year.

In Global Biscuits and Snacks organic sales increased 2%, with growth in Pepperidge Farm and the Asia Pacific region. Sales gains in Pepperidge Farm were driven by Goldfish crackers, fresh bakery and frozen products, partly offset by a decline in cookies.

In the Asian Pacific region excluding the impact of currency translation, growth in Australia biscuits from savory and sweet varieties were offset by declines in Indonesia biscuits, as that market is facing some economic challenges. Operating earnings increased 16%, primarily driven by a higher gross margin percentage, volume gains and lower selling expenses, partly offset by the negative impact of currency translation.

In the Campbell's Fresh segment, consistent with our expectations, organic sales decreased 3% due to anticipated declines in carrot ingredient export sales, and category declines in retail carrots, partly offset by mid single-digit sales growth in Bolthouse Farms beverages and salad dressings.

Not included in organic results is our recent acquisition, Garden Fresh Gourmet, which contributed 11 points of sales growth to this segment. Including the acquisition, the integration of which is going well, reported segment sales increased by 8%.

Operating earnings doubled to $18 million driven by a higher gross margin percentage and the impact of acquiring Garden Fresh Gourmet. The improvement in gross margin reflects lower carrots costs and the favorable mix impact of the growth in the higher margin beverages and salad dressing business relative to the balance of the segment.

We had strong cash flow performance in the first quarter. Cash from operations increased by $30 million to $218 million driven by higher cash earnings. Capital expenditures increased $9 million to $71 million. We paid dividends totaling $100 million, reflecting our current quarterly dividend rate of $0.312 per share.

In aggregate we repurchased $32 million of shares in the first quarter, $25 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 was equal to the prior year at $3.8 billion, as positive net cash flow generated by the business offset the impact of the $232 million acquisition of Garden Fresh Gourmet.

Now I'll review our revised 2016 guidance. We are now forecasting lower than anticipated cost deflation and cost savings in excess of our previous target. Compared to our previous cost inflation outlook of 2% to 3%, we now expect inflation and cost of products sold to be approximately 2%, and for our gross margin to increase by approximately 1 percentage point. Compared to our previous incremental cost savings goal of $60 million, we now expect to deliver savings in the range of $80 million to $100 million in FY16. Our cumulative cost savings target of $250 million through FY18 remains unchanged.

Going in the other direction, we are experiencing some headwinds on the tax line, and now expect an adjusted tax rate of approximately 32%. And as I mentioned earlier, we also expect the negative impact of currency translation to increase to 3 points, as the US dollar continues to strengthen. This revised earnings guidance reflects additional investment in innovation, as well as our current expectations for the performance of our business for the remainder of 2016.

Relative to our previous growth rates, we are increasing adjusted EBIT and adjusted EPS growth by 2 to 3 points on a currency neutral basis, with an offset to sales, EBIT, and EPS of 1 point due to the increased negative impact of currency translation. From the recasted 2015 base, and including a 3 point negative impact from currency, we now expect sales to change from minus 1% to 0%, adjusted EBIT and adjusted EPS to both increase 4% to 7%. The guidance also includes the impact of the Garden Fresh acquisition which adds 1 point to both sales and adjusted EBIT.

Given that there have been significant changes to our guidance, including the impact of the change in benefit accounting, we thought it would be helpful in this instance to bridge our EPS guidance in September to the revised guidance we issued today. Starting with the original guidance of $2.53 to $2.58, we've added $0.19 for the benefit accounting change, and deducted the incremental currency translation headwind which is worth $0.03 per share.

With the upside from lower than anticipated inflation and incremental cost savings, we have taken the opportunity to fund additional investment in longer term innovation. The improved operating performance, net of the additional investment is adding $0.06 to $0.09 to the guidance.

Relative to our first quarter EPS growth, keep in mind that about half the Q1 EPS growth comes from marketing timing, which we anticipate will be spent back in the year to go period. 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. Since we are on limited time, out of fairness to others -- to other callers, please ask only one question at a time. Okay, Stephanie?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Eric Katzman from Deutsche Bank.

Eric Katzman - *Deutsche Bank - Analyst*

Hi, good morning, everybody.

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

Hi, Eric.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Hi, Eric.

Eric Katzman - *Deutsche Bank - Analyst*

Happy Holidays to all of you.

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

Thank you, you too.

Eric Katzman - *Deutsche Bank - Analyst*

I guess, with the respect for the one question, I guess Denise and Anthony, what struck me this quarter most, was how high the margins are in the Simple Meals area with the cost savings program, versus how low the margins are in the Campbell Fresh division, with obviously most of the growth expected to come in the latter. I mean, is that kind of low -- the single-digit kind of margin, what we should assume is reasonable long-term for the fresh division, and is it -- on the long-term basis, is it going to be how you balance the two to get to the consolidated goals? I'll pass it on, thanks.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes, I think the one thing to point out within Campbell Fresh, is that you need to parse apart the components of that business. So half the business is the CPG side, which is the beverages and salad dressing. The other half is the Farms business which includes the carrots business and the ingredient export business. The margin structure within Campbell Fresh is very diverse. So the CPG businesses carry a much higher margin than the carrots and natural ingredients business. And in fact, that's where all the growth is. So even within the quarter, we see gross margin expansion within Campbell Fresh, because of the higher growth on the higher margin beverages and salad dressing.

So if you think about the algorithm, you need to think about not just the Campbell Fresh margin, but the faster growing CPG margin within that. The other thing that happens to Campbell Fresh because of the Bolthouse acquisition, it carries a pretty high load of depreciation and amortization. The EBITDA margin is about 2 times the operating margin you see on the chart, so that's another thing to keep in mind. But we think the algorithm works.

Eric Katzman - *Deutsche Bank - Analyst*

Thank you.

Operator

Our next question comes from Matthew Grainger with Morgan Stanley.

Matthew Grainger - *Morgan Stanley - Analyst*

Hi, good morning. Thanks for the question. Denise, you've talked a lot in recent quarters about the benchmark historically of 24%, 25% of sales in advertising, consumer and trade. And it seems -- I know some of this is phasing, but just through the year. But it does seem like you're pulling back and rationalizing where you see unproductive spending across the board, on all of these areas of the P&L. So I guess, are we any closer at this point to where you might see an opportunity to shift that benchmark down slightly? Or is that still the right way to think about the degree of marketing reinvestment you need in the business to drive the top line goals?

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

Yes. I mean, we still believe that ACT at about 24% of sales is a competitive rate. This quarter, we actually spend ACT at 23% of sales. There's a number of things going on there. First of all, in the US soup business, we shifted our advertising back to later in the year, and started the new campaign in October versus prior year, so you're seeing the result of that.

In addition, we're shifting our spend overall to about 40% of our spend in digital. And that is creating a different dynamic between working and non-working media. And with our cost savings efforts, we're trying to be as responsible and efficient as possible in the area of non-working media. And when you shift to digital, you're spending a lot of time and expense on content, but TV is just a different dynamic. And so, and then within trade, we have been increasing trade on a couple businesses in biscuits and Campbell fresh, and we actually took pricing in our soup business. So we'll be working on our merchandising and promotion programs with more acceleration in the second and the third quarter.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay. Thanks, Denise. I guess, I'll stop there.

Operator

Our next question comes from David Driscoll with Citigroup.

David Driscoll - *Citi Research - Analyst*

Thank you, and good morning, everybody.

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

Hi, David.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Good morning, David.

David Driscoll - *Citi Research - Analyst*

I'd say, I'd like to wish a Happy Holidays to you all as well. Wanted to just ask some -- one question on soup, and apologies, Ken, just a couple of minor points here. Just overall, the ready-to-serve performance, certainly quite weak. I know you hate talking about weather, but does it matter at all about the temperatures that we saw in the quarter? Would that give us any explanation here?

And then the second part of this question on soup is, is the performance here kind of indicative of maybe -- or maybe not this negative on some pieces of it, but just that you're going to really manage this soup business for cash? And this is really almost the philosophies of zero-based budgeting coming through, where we are going to get some really nice answers on the profit line, but maybe the sales line is just fundamentally going to see some weakness as you rationalize unprofitable promotions et cetera. So those two pieces, if you will?

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

Okay, I'll take that one. First of all, the soup business declined 2% after wrapping 6% increases in the year ago comps. And what we believe drove that -- and that was as expected by the way, was the pricing increases that we took which predominantly affected the RTS business, the fact that promotions have been shifted to later in the year, and the fact that advertising started later in October. The consumption was down in line with our expectations.

I would say to you that RTS is a bit worse, condensed a bit better, and broth was pretty flat, but the category was down 4%. And although I'm not a weather person, I do think that that was a factor, but I believe that all these other dynamics going on were equal factors to that one. And then, of course, our Fresh-Brewed soup is not captured in our consumption. That's in dry soup. Inventories were comparable. We saw a little bit of a difference in broth because we carried some extra inventory into the year, as we transition to a new screw cap on the aseptic broth. We still expect soup to grow modestly, and that's basically how we're looking at it.

David Driscoll - *Citi Research - Analyst*

Okay. Thanks for the comments.

Operator

Our next question comes from Robert Moskow with Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Hi, thank you.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Hi, Rob.

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

Hi, Rob.

Robert Moskow - *Credit Suisse - Analyst*

Hi. Obviously, the gross margin performance was a lot higher than what anyone had expected. The guidance is for 100 basis points for the year though. I think you're up 300, versus year ago already, so why not higher, Anthony? Is it a function of the promo spending is going to start increasing in the second quarter? Or is it a function of -- by fourth quarter, I think you start lapping some of the supply chain improvements. Why not higher?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes. I guess, there's a couple of comments, and I'm sure you guys will do the math. But following a 260 basis point improvement in the first quarter, driven by primarily net price realization and our productivity gains, getting to 1 full point on the year would imply for the last three quarters about 40 basis points of expansion. And there's a couple of points I would make. I made them -- I said in my comments that COPS inflation was 1% in the quarter. We expect that to be closer to 2% by the time we finish the year.

And that includes this negative currency impact on the input costs of some of our international businesses, primarily the Canadian business and the Australian business. So that headwind is out there. You made the comment about some of the marketing timing, the favorability in the first quarter, that will come back in the last three quarters. The second quarter comp is not too difficult, but it will start to lap some of the gross margin gains we had last year in the back half. So all those things taken together, would dampen that growth in the year to go period.

Robert Moskow - *Credit Suisse - Analyst*

Okay. Thank you very much.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Sure.

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.

Jason English - *Goldman Sachs - Analyst*

Thank you for squeezing me in. I wanted to come back to some of the trade budget optimization questions, and some of the comments you made. As we look at the data, TBO seems to be a very big opportunity for you in soup, in some of your other Simple Meals categories, yet it's been a source of leakage for you for a number of years. And I heard a reference to maybe a little bit less trade this quarter on soup, but I also thought I heard reference to actually increasing those[not audible] funds to mitigate some of the price increases you had going forward.

So A, is that right that you are going to ramp more trade, to deal back some of the price increases? B, do you concur with the broader observation that there seems to be able big opportunity to pull some of those inefficient dollars out? And then C, what's the obstacle, what's the hang-up for getting this going in the right direction for you?

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

I believe that we have an opportunity as a Company to get a better return on our trade dollars invested, and I like to think of it that way. We, as part of our restructure within our integrated global services are building our revenue management capabilities, not only in the Americas business but across all three, and we have different dynamics, competitive dynamics that we're dealing with.

I think the second goal is we are getting better net price realization. That has come from not only list price increases, but also working with promoted pricing. These are still early days, and we want to make sure the consumer response to them, while they've been accepted by customers, and we're trying to find win-win solutions for ourselves and our customers with our trade programs. So that's basically where we are right now, and we will definitely keep a close eye on it.

Jason English - *Goldman Sachs - Analyst*

Thank you. Good luck.

Operator

Our next question comes from Jonathan Feeney with Athlos Research.

Jonathan Feeney - *Athlos Research - Analyst*

Hey, Denise. Thanks very much for the question. I wanted to ask a little bit bigger question in light of your comments today. Obviously, some strong gross margin here, and I think a lot of the questions were grasping at, how much revenue management versus growth is your focus as a Company? And specifically your comment today, that you want to set Campbell apart, I think you said from other food companies, and strengthen your growth trajectory I think you said.

What metrics do you want to set Campbell apart on? I mean, what should we be judging you on over the next -- on what metric did you mean that Campbell would be set apart? Is it gross margin improvement? Is it operating income, segment income? What would you say to that?

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

I mean, we've been on a mission to generate better profitable sales growth. And also at the same time, unlock the potential of our purpose to be and set a standard for -- a new standard for transparency in the industry, which we believe will help us in achieving that trajectory of profitable net sales growth. That hasn't really changed. But it has been refined, in the fact that we now have assigned the portfolio roles to the divisions, and we believe that in composite, it better diversifies our portfolio to gain that. I mean, I think that we've guided with our long-term targets as to what we believe we can achieve in the next several years, and we're still working our way into those. We believe that organic growth will be an important part of this, but it will also -- we continue to look and be very disciplined about making strategic acquisitions.

Jonathan Feeney - *Athlos Research - Analyst*

So I guess, relative to -- I guess, so it's pretty much just the long-term guidance you're talking about, that sort of commentary, just maybe setting Campbell apart from the other food companies doesn't relate directly to the financial metrics, maybe the transparency you're providing or other things?

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

I'm not sure.

Jonathan Feeney - *Athlos Research - Analyst*

Well, I guess, what I'm saying Denise, is the long-term guidance you have is pretty similar to what a lot of other companies have. And I hear you have some strong -- I see you have some strong results today. And I think you've been very -- some interesting things going on in the portfolio. And I guess, I'm trying to see if there's something new afoot here, or just maybe a new level of steps behind what you've talked about for some time?

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

No, I think our strategy has been pretty consistent. I mean, we're establishing a real beachhead in fresh food, bringing Campbell's suite of capabilities to that faster growing part of the food business. We are being really transparent about our products with our new website, whatsinmyfood.com. We are talking to consumers about what's in our food, and the ingredients we use, and how its made. And these are just steps that really distinguish us, and are very true to activating our purpose with the consumer. And from all our research, whether it be with millennials or even baby boomers now, consumers are going to purchase the products that from companies that align with their values, and we believe we have a very strong statement out there.

Jonathan Feeney - *Athlos Research - Analyst*

I see what you're saying. Thanks very much. It's very helpful. Happy Holidays.

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

Thanks, you too.

Operator

Your next question comes from Chris Growe with Stifel Nicolaus.

Chris Growe - *Stifel Nicolaus - Analyst*

Hi, good morning.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Hi, Chris.

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

Hi, Chris.

Chris Growe - *Stifel Nicolaus - Analyst*

Happy Holidays as well to you. Just had a quick question for you here. I wanted to understand on, in the soup business, would you -- so inventory levels were in line with the prior year, if I heard you correctly there, Anthony. Does that mean that they are up a little bit from what they were at the end of Q4? I'm just trying to get a sense of where they stand today, and how to expect that to move going forward. And when I look within the performances of condensed, ready-to-serve and broth, condensed is the one that seems to stand out a bit, versus like what the measured channel data indicated. So is that the one where there, was a little inventory increase in condensed in the quarter, is also part of the question?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

So to the first part of the question, we always build retail inventories in the first quarter. So we always come into the quarter relatively low. We're getting into the season, and we always build. The question then becomes, did you build more than you did the year ago period? The answer to that in aggregate is no. The retailer inventories on a case basis, we came into the quarter, and ended the quarter about the same.

And then if you look underneath that by sub category, I would say that condensed and RTS got a little bit of benefit, and broth saw a little bit of negative, in terms of the impact of shifts within the portfolio. But I think where we ended the quarter, is kind of a normal place for us relative to the seasonal build we typically see in the business.

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

Yes. Another -- just another build on what Anthony said, our sales on broth in the quarter were down 9%, and we were cycling comps of plus 17% a year ago, and our consumption in the quarter was flat. So that also was a factor to evaluate the performance.

Chris Growe - *Stifel Nicolaus - Analyst*

So in the context of your promotional spending plans, usually promotional spending is working down, as I think it did this quarter, but you tend to see inventories come out of the system. Is that what you expect for the year then, or can you go that far to speak to that?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes. By the time we cycle the full year and get to the end of the full quarter, it's typically our low point in the cycle. So all this stuff that happens as we build into the season, come out of the season, works it -- generally works its way out by the time we get to the end of the fourth quarter.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay. Well, that's very helpful. Thank you.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Sure.

Operator

Our next question comes from Alexia Howard with Bernstein.

Alexia Howard - *Bernstein - Analyst*

Good morning, everyone.

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

Good morning, Alexia.

Alexia Howard - *Bernstein - Analyst*

Hi. So [let me ask] about some other parts of the business, specifically V8, cookies, and then SpaghettiOs which I know is fairly small. But in each of those, it's a similar pattern to what we're seeing in soup. You seem to be trading off market share, in exchange for better EBIT and better price realization. Should we expect those trends to continue, or are you scrambling to try to turn it around? I'm just trying to get an idea of the strategy there? And then just some comments on SpaghettiOs, it looks as though even before the recall the sales were really coming down quite heavily. Is that something you're kind of pulling away from? Thank you.

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

Let me tackle beverages first. The category continues to remain challenged, although we have seen some signs of improvement, our consumption in share were down slightly in quarter one. We have a couple puts and a couple takes. V8 Splash and V8 Plus Energy continued to perform well, and we're very encouraged by our V8 Veggie blends launch, and we've had a bit of decline on our V8 red juice. And so, I think that's due to consumers trying some different types of vegetable juice now in the Veggie blend line, and our V8 V-Fusion business continues to be a challenge.

We've had a couple quarters of good growth in immediate consumption, and we had some trade timing issues in the quarter. So that was down about 1%, but our equivalent volume in that channel was up 8%. So we continue to be encouraged about the new network we've set up there. We know that's an opportunity there for us.

And finally, we launched our Veggies For All Campaign, and we really like what that's doing for the brand in terms of the equity. So we're still very committed to the V8 program. We think it's a timely, on-trend brand for the health conscience consumer that offers a lower calorie option, and less sugar option in this world of juice. Cookies, we just saw -- no pun intended, we saw a softness on our cookies predominantly in the classic line; however, we did have a really, really good quarter on Goldfish crackers up 10%. So we still have more work to do on cookies. And SpaghettiOs? (multiple speakers)

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes, I can do --

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

Yes, go ahead.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

The premise of the question, I would disagree with a little bit. I mean, the price realization on soup is relatively unique to soup. We haven't done a lot of price realization on V8, cookies or SpaghettiOs. The SpaghettiOs sales are relatively flat in the quarter. V8 down is primarily a V8 V-fusion issue. And as Denise mentioned, Chunk cookies are a particular issue within the Pepperidge Farm portfolio that we're addressing, but we haven't made a strategic decision in those businesses to go for price realization and better EBIT in exchange for market share.

Alexia Howard - *Bernstein - Analyst*

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

Operator

Our next question comes from David Palmer with RBC Capital Markets.

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

Hi, David.

David Palmer - *RBC Capital Markets - Analyst*

Thanks, and happy Thanksgiving.

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

You too.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Thanks, David.

David Palmer - *RBC Capital Markets - Analyst*

Just a follow-up there on your crackers business, and particularly you mentioned Goldfish being strong. That has been a tough category for a lot of companies, the healthy snacking area. What perhaps is going right there for you, and how confident are you that you can keep that going? And then on cookies, that's become tougher for a variety of players there, and it seems like sweet snacks in general has been tough. What is the plan for that segment? Thanks.

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

Well, we definitely have been very focused on keeping our Goldfish programming strong. I think that business is hitting on all cylinders with good advertising, a good promotional program, and the right proposition for millennials parents and their children. So we continue to be pretty excited about our Goldfish business. And I think that mothers still feel like that is a very positive snacking for their children. I think we need -- we have more work to do on cookies, and we're working on that as we speak. We do have new leadership right now in the Pepperidge Farm business, and that team is really coming together and focusing on the next wave of innovation ideas. And I'm not sure there's anything more to add to that.

David Palmer - *RBC Capital Markets - Analyst*

Okay. Thank you.

Operator

Your next question comes from Priya Ohri-Gupta with Barclays.

Priya Ohri-Gupta - *Barclays Capital - Analyst*

Thank you for taking the question. I was hoping you'd talk a little bit about your view on the current rate environment, specifically you had a $1.5 billion in short-term borrowings. Do you expect to continue [rolling this in the market or refinance it] (audio difficulties)?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Yes. So as I mentioned, we did term out some of the debt portfolio in the recent past, taking advantage of relatively low fixed rates. We have a sizeable backstop credit facility against the commercial paper program, and we're fairly comfortable with the level of CP we have in the marketplace today. I mean, clearly, what's happening in the credit markets, we continue to look at that, and to evaluate alternatives, whether to term out some of that CP, or whether the use of the derivative market to convert some of that floating exposure to fixed. But that's an ongoing thing that we continue to assess here.

Priya Ohri-Gupta - *Barclays Capital - Analyst*

Thank you very much.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

You're welcome.

Operator

I'm showing no further questions. I will now turn the call back over to Management for closing remarks.

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

All right. Thank you, Stephanie. From all of us at Campbell, Happy Thanksgiving, everyone. Thanks for joining our call. A full replay will be available about two hours after our call concludes by going online or calling 1-703-925-2533. The access code is 1665411. You have until December 8 at midnight, at which point all of our earnings calls will be strictly on the website under news and events. If you have any further questions please call me, Ken Gosnell at 856-342-6081. If you are a reporter with questions, please Carla Burigatto, Director of External Communications at 856-342-3737. This concludes today's program. Thank you.

Operator

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