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Campbell Soup Co. (CPB)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, ladies and gentlemen. And welcome to the Campbell Soup Company Third Quarter 2022 Earnings Conference Call. At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Rebecca Gardy, Chief Investor Relations Officer. Please, go ahead.

Rebecca Gardy

Senior Vice President & Chief Investor Relations Officer, Campbell Soup Co.

Good morning. And welcome to Campbell's third quarter fiscal 2022 earnings conference call. I am Rebecca Gardy, Head of Investor Relations at Campbell Soup Company. And joining me today are Mark Clouse, Campbell's President and Chief Executive Officer; and Mick Beekhuizen, Campbell's Chief Financial Officer.

Today's remarks have been prerecorded. Once we conclude our prepared remarks, we will transition to a live webcast Q&A session. The slide deck and today's earnings press release have been posted to the Investor Relations section on our website, campbellsoupcompany.com. Following the conclusion of the Q&A session, a replay of the webcast will be available at the same location followed by a transcript of the call within 24 hours.

On our call today, we will be making 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 3 or our SEC filings for a list of factors that could cause our actual results to vary materially from those anticipated in forward-looking statements.

Because we use non-GAAP measures, we have provided a reconciliation of each of these measures to the most directly comparable GAAP measure in the appendix of this presentation.

On slide 4, you will see today's agenda. Mark will share his perspective on our third quarter performance as well as in-market performance by division. Mick will discuss the financial results of the quarter in more detail and then review our guidance for the full year fiscal 2022.

And with that, I am pleased to turn the call over to Mark.

Mark A. Clouse

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

Thanks, Rebecca. Good morning and thank you for joining our third quarter earnings call for fiscal 2022. As you read in our press release, we reported strong year-over-year performance. While expected, the performance represents a positive proof point for our continued successful execution in what remains a highly dynamic environment.

Over the last several years, we've been navigating substantial headwinds, including the ongoing impact of COVID-19, labor and supply pressures, significant transformation and a rising level of inflation. The team has done a great job of controlling the controllables.

We have improved our execution and strengthened our supply chain by increasing labor and capabilities, while working with our retail partners to deploy inflation-driven pricing effectively and thoughtfully. Our results this quarter reflect this work.

We delivered accelerated growth in sales, driven by continued consumer demand for our brands and significantly improved supply. The underlying health of our portfolio remained strong, though, we did experience some expected share pressure due to select remaining supply constraints and private label improvement in certain categories.

Also returning to growth were adjusted EBIT and adjusted EPS, reflecting our successful efforts to mitigate inflation and recover on labor and supply. Although, we expect the environment to remain challenging, we are confident that we are on a considerably stronger foundation and in a much better position to navigate the volatile macro environment moving forward.

Our year-to-date performance and improved execution have led us to raise our previously communicated net sales guidance for the year. We are maintaining our adjusted EBIT and adjusted EPS guidance for fiscal 2022 to reflect the ongoing inflation pressure.

Now let's cover some specifics from Q3. Organic net sales were up 9%, primarily driven by the impact of our second wave of inflation-driven pricing, which is now reflected on shelf across both divisions. Our service levels also continued to recover, supported by improved labor hiring and retention, which enabled us to meet this demand, recover distribution, and enable retailers to begin to rebuild product inventories.

Volume declined in the quarter, driven by select labor and materials constraints and some price elasticities, albeit much lower than historical levels. We anticipate and have plans for similar volume trends going forward where demand and inventory replenishment is mitigated by some ongoing materials availability and price elasticity. We are remaining vigilant on elasticities with a variety of contingency plans in place if they begin to accelerate.

Turning to profit. Net price realization and our strength in supply chain execution offset the impact of accelerating inflation and lower volume, resulting in a 23% increase in adjusted EBIT and a 37% increase in adjusted EPS in the quarter.

While our adjusted EBIT margin was up 190 basis points versus the prior year, I want to remind you of our challenging margin performance in the prior-year quarter. I would characterize the improvement as more of a stabilization than a full recovery as the combination of our pricing actions, productivity improvements, and cost-savings initiatives began to catch-up with the current inflation in ingredients, packaging, freight, and labor. We expect continued inflation pressure going forward and have already announced a third wave of select pricing to take effect as we transition into fiscal 2023.

Now turning to in-market performance for the quarter, we saw increased consumption across both businesses. In-market performance remained positive, up 4% versus the prior year. Net sales were five points ahead of consumption in the quarter, reflecting the retail inventory rebuild previously noted. On a three-year basis, consumption grew 14%.

Turning to slide 8, building on our in-market performance, briefly discussed on the previous slide, we are very excited about the continued consumption and share growth of our key brands. In fact, all our key brands have grown consumption considerably over the last three years, with many of our most important brands at or above pre-pandemic share levels.

That said, we experienced some short-term market share pressure on certain brands as we expected. These share losses tend to line up very closely with where our distribution levels were down, evidence that supply was one of the key drivers of this pressure. As we continue to recover distribution and are fully supporting our portfolio, we expect to see ongoing share recovery. We are already seeing this recovery in Snacks in the most recent period. In the quarter, we also experienced some continued share pressure from private label, following their distribution recovery and the market's higher overall prices causing some trading down.

Turning to Meals & Beverages. I continue to be pleased by the underlying health and strength of demand for our portfolio. Organic net sales in the division increased 9% versus prior year. Consumption grew 4% over prior year, including brands in four of our five core categories. We feel great about the progress we've made, especially when you compare this business to where we were three years ago prior to the pandemic, with consumption growth of 14% over that period and share gains in many of our categories.

Let's turn to the next slide where I want to spend a moment framing how the Meals & Beverages portfolio is poised to win in the current dynamic environment of accelerating inflation and some recent trading down consumer behaviors.

In times of rising inflation, out-of-home meals are the number one occasion people cut back on. Grocery store occasions are the number one go-to occasion when consumers feel pressure. Despite recent average prices on shelf increasing in our key categories of soup and Italian sauce in the low to mid-double digits, volumes are still elevated versus the prior year, indicating that both the soup and Italian sauce categories are staying in consumers' baskets as prices are rising.

In fact, even in categories where we may be experiencing some share pressure from private label, it is consistently where consumers tend to be trading down into our categories, driving overall accelerated growth. As an example, in condensed soup where private label share has expanded, the category and Campbell's are

growing significantly at 9% and 6%, respectively, versus the prior year. To keep fueling this growth, we are also continuing to shift our marketing message toward more value.

Turning to our soup portfolio on slide 11. In-market soup consumption continued to grow, increasing 5% versus prior year, and 14% compared to three years ago. In the quarter, we continued to see strong share performance on key brands, but as expected, we did see pockets of share pressure, in particular, on condensed soup and Swanson, where inflation and slower private label pricing put some pressure on share.

However, we remain very confident in our overall competitive position. One proof point is we are growing shares in key strategic areas like our condensed icons, Chicken Noodle, Tomato, Cream of Chicken and Cream of Mushroom, the largest SKUs in the condensed business. In addition, overall share in condensed is up nearly 2 points versus three years ago prior to COVID-19, even with the most recent recovery of private label.

Finally, on condensed, we are thrilled that we are retaining the younger millennials that we have added in the last three years. The share losses tend to be more concentrated in the baby boomer cohort, who are a bit more price-sensitive. As a result, we are very pleased to see our new consumers remain committed to our brand and our household retention remains high.

On our ready-to-serve, or RTS business, share was down in the quarter due to the prioritization of core brands, Chunky and Well Yes! In fact, Chunky's strong performance resulted in 14% dollar consumption growth and nearly 2 points of share growth versus prior year.

In the third quarter, Prego consumption increased 7% versus the prior year. Versus three years ago, consumption's up 25% and repeat rate up nearly 5 points. Prego also continued to maintain its share leadership in the Italian sauce category.

For Pace, a significant recovery in service during the quarter drove share growth of 0.2 points and household penetration of plus 0.5 points, and added 800,000 new households in the quarter, driven primarily by millennials versus the prior year. Versus three years ago, we grew consumption 14%, and we're pleased with our strong progress to-date and remain confident in our ability to achieve our goals of building a \$1 billion sauce business.

As we outlined in our Investor Day in December, driving the core is critical to achieving our goals, as is meaningful innovation and smart M&A. On slide 13, we're excited to share a glimpse into our Meals & Beverages innovation plans for fiscal 2023. Innovation on our business is critical. And now with supply improving, we can focus on rolling out a robust pipeline of new products.

Starting with a new innovative approach to home quick scratch meals, we'll be launching our Campbell's flavorup! line. This brings a versatile concentrated flavor sauce that will enable a variety of recipes, and the consumer can control flavor intensity and portions, a quick meal for one or a convenient family dinner.

Prego will also be expanding its lineup in fiscal 2023 as consumers continue to eat more at home to save money and seek value in the current inflationary environment. Younger consumers, especially, are seeking new specialty flavors and ways to enhance their at-home meals. Prego's new items will offer bold flavors to meet the growing need to bring greater variety to the in-home Italian sauce experience.

Chunky Spicy, which is adding to the strong results of this important brand, will also be expanding their lineup in fiscal 2023. In fact, Chunky Spicy Chicken Noodle, launched earlier this year, is already rapidly approaching the

first quartile of all ready-to-serve soup with strong trial and repeat. We are also launching an Old Bay Seasoned variety of Clam Chowder in conjunction with the limited edition launch of Old Bay Seasoned Goldfish.

Finally, we're also excited about Pacific ready-to-serve soups and chilis, which we'll be launching in the fourth quarter of fiscal 2022. We continue to drive innovation in this business and expect these new products to be a significant growth driver next fiscal year, solidifying our leadership in organic soup. The combination of our Chunky, Well Yes! and now organic Pacific ready-to-serve soup will create a formidable portfolio and a full range of choices for all consumer cohorts and price points.

Turning to our Snacks division on slide 14. We delivered organic net sales growth of 8% versus prior year. We also experienced strong in-market performance of 4% over the prior-year quarter and 14% on a three-year basis. This acceleration in growth reflects the continued underlying strength of our brands, especially our power brands and significant improvement in our supply chain and service levels.

Our Snacks power brands continue to fuel performance with in-market consumption growth of 6% versus the prior year and 19% compared to three years ago, reflecting our efforts to prioritize power brands. We feel good that six of eight of our power brands grew consumption year-over-year, with the exceptions being late July and Pepperidge Farm cookies, both of which were negatively impacted by our remaining supply challenges.

With respect to share, we experienced some expected pressure on our power brands as supply and promotional recovery took time through the quarter. Great examples of brands where supply is in place and we're supporting the business fully include both Kettle Brand and Cape Cod potato chips, with share gains of 1.5 points and 0.2 points, respectively.

Additionally, we have seen very little elasticity or trade down due to price sensitivity so far. This is true more broadly across all of salty snacks. In fact, private label and value brands lost share in the Snacks category in the quarter. Another standout has been our largest Snacks brand, Goldfish, which has grown from a favorite kids' food to a top choice of their teen siblings and their parents. In the quarter, Goldfish consumption was up 8% and up 18% on a three-year basis.

On slide 16, I'll highlight a few of the recent Goldfish new product successes. Family Size and Mega Bites are the number one and number two fastest turning cracker innovation in calendar year 2022, fueling a buy rate increase of 11.4% year-over-year for this iconic brand.

Family Size is overdelivering across all metrics, with strong velocity, distribution and trial. Goldfish Mega Bites continues to outpace our target and overdeliver on our expectations, driven by strong velocity, trial and repeat rates. Our strategy to broaden our consumer base is working, as evidenced by more than half of buyers being households without children and Mega Bites performing well with older consumers.

Additionally, we're building upon the successful limited time-only strategy that brought Frank's

RedHot and Jalapeño Popper Goldfish to consumers. We recently launched our Old Bay Seasoned Goldfish. We quickly created a buzz among a passionate consumer base, logging more than 1 billion impressions in 48 hours. The product sold out within nine hours on Shop McCormick, with velocities very strong across all retail outlets.

To conclude, while we feel very good about the progress we've made, the operating environment remains challenging, and we expect ongoing margin pressure from inflation. However, we're in a better position to navigate it and now very much on our front foot.

Going forward, in Q4, you should expect to see us: one, continue to work hard to use all our tools to combat inflation and manage margin pressure; two, leverage improving supply and execution to further recover distribution and inventory levels; three, return promotional and marketing investment to strengthen competitiveness and combat private label trade down; and finally, four, work to create a compelling fiscal 2023 plan that balances the many nearing challenges while maintaining the momentum and progress on our long-term strategic plans.

Although this environment may be different than our original expectations, we are pleased with the continued progress on the business and remain very confident in our ability to achieve our long-term objectives.

With that, let me turn it over to Mick to discuss our results in more detail.

Mick J. Beekhuizen

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

Thanks, Mark. And good morning, everyone. We delivered solid growth in the third quarter across net sales, adjusted EBIT and adjusted EPS amidst meaningful macro headwinds.

As Mark reviewed, the sustained consumer demand for our portfolio of brands, improved supply chain execution, combined with inflation-driven pricing and limited elasticities resulted in strong top line growth. Our productivity improvements and the benefit of continued cost-savings initiatives helped mitigate a continued inflationary environment, driving growth in both adjusted EBIT and adjusted EPS in the quarter.

Q3 adjusted gross margin performance represented a gradual recovery of the year-to-date impact of significant inflation and select supply chain constraints. Also recall, that we are lapping a favorable prior-year comparison.

Our cash generation remains strong with cash flow from operations of \$1.1 billion through the first nine months. Additionally, in line with our commitment to deliver value to shareholders, we have returned over \$450 million year-to-date to shareholders through dividends and share repurchases.

As I will review in more detail in a moment, we are raising net sales guidance based on our performance year-to-date as well as our expectations for continued strong consumer demand for our brands, limited price elasticities, continued supply recovery and improved service levels. Given the persistent inflationary environment, we are reaffirming our full year guidance on adjusted EBIT and adjusted EPS.

Turning to the next slide. Organic net sales increased 9% in the quarter as consumer demand was strong and we experienced limited price elasticities. Third quarter organic net sales performance outpaced consumption in measured channels by five points, primarily driven by retailer inventory rebuild.

Adjusted EBIT increased 23% compared to prior-year quarter due to improved adjusted gross margin performance and lower marketing and selling expenses, partially offset by sales volume declines and lower adjusted other income. Adjusted EBIT margin increased by 190 basis points to 15.1% compared to 13.2% in the prior year.

Adjusted EPS from continuing operations increased 37% to \$0.70 per share, driven primarily by the increase in adjusted EBIT, lower adjusted net interest expense and the benefit of lower weighted average diluted shares outstanding. Year-to-date, organic net sales increased 1% and adjusted EBIT decreased 7% compared to the

prior year. Adjusted EBIT margin decreased by 110 basis points to 15.6% compared to 16.7% in the prior year. Year-to-date, adjusted EPS decreased 2% versus the prior year.

On the next slide, I'll break down our net sales performance for the third quarter. Inflation-driven pricing more than offset the impact of volume declines in the quarter as we experienced lower than historical price elasticities. Organic net sales increased 9% during the quarter, driven by 11 points of favorable pricing, reflecting inflation-driven price increases. This was partially offset by a three-point volume/mix headwind, reflecting select supply constraints as well as price elasticities, partially offset by retailer inventory rebuild. The impact of the sale of Plum subtracted one point in the quarter. All in, our reported net sales increased 7% over the prior year.

Turning to the next slide. Our third quarter adjusted gross margin increased 90 basis points to 31.5% from 30.6% last year. In addition to lapping a sizable decline in the prior year, this margin expansion represents a gradual recovery of the significant year-to-date impact of increased cost inflation and other macro issues, such as labor and materials availability.

Net price realization drove an 800 basis points improvement due to the impact of our inflation-driven pricing actions, which only partially offset the inflationary headwinds experienced in the quarter. Our ongoing supply chain productivity program and our cost-savings program contributed 110 basis points and 20 basis points to adjusted gross margin, respectively.

Inflation/other had a negative impact of 790 basis points, with the majority of the impact driven by cost inflation, as overall input prices on a rate basis increased by approximately 15%. Along with other industry participants, we experienced the impact of significantly increasing cost inflation and other macro issues, such as labor and materials availability.

Other supply chain costs had a favorable impact as we lapped higher other supply chain-related costs in the prior-year third quarter, including those related to last year's Texas storm, which caused a temporary disruption to the Meals & Beverages division supply chain operations. In addition, we received a onetime benefit in the current year for insurance claims related to the Texas storm. The benefit of these items improved our adjusted Q3 gross margin year-over-year by approximately 100 basis points.

Lastly, volume/mix had a negative 50-basis point impact on gross margin, largely due to reduced operating leverage. The previously described initiatives to mitigate inflation, highlighted on the next page, includes price increases and trade optimization, supply chain productivity improvements and cost-savings initiatives, and a continued focus on discretionary spending across the organization.

We remain focused on the inflation mitigation as we expect core inflation for the year to be low-double digits, with a more pronounced impact in the second half of fiscal 2022. Our wave two pricing was fully reflective throughout the third quarter. And as Mark noted in his opening remarks, we have already announced a third wave of select pricing to help mitigate the continued increase in inflation as we head into fiscal 2023.

Moving on to other operating items. Marketing and selling expenses decreased \$14 million or 7% in the quarter on a year-over-year basis. Advertising and consumer promotion expense, or A&C, declined by 16% in the quarter as investments were moderated, due in part to the pacing of supply recovery and some ongoing materials availability issues. Overall, our marketing and selling expenses represented approximately 9% as a percentage of net sales, which was in line with our expectations.

Adjusted administrative expenses increased \$4 million, or 3%, to \$146 million. As a percentage of third quarter net sales, adjusted administrative expenses were 6.9%, a 30-basis point decrease compared to last year.

On the next slide, we are providing an adjusted EBIT bridge to summarize the key drivers of performance this quarter. As previously mentioned, adjusted EBIT increased 23% in the quarter, primarily due to a 90-basis point or \$87 million improvement in adjusted gross margin.

Lower marketing and selling expenses contributed \$14 million or 140 basis points to our adjusted EBIT margin. The continued headwind of sales volume declines, primarily from the impact of select supply constraints as well as price elasticities, partially offset by retailer inventory rebuild, negatively impacted EBIT by \$24 million.

Lower adjusted other income had a negative impact of \$13 million or 70 basis points. Despite adjusted administrative and R&D expenses increasing \$4 million versus the prior year, it was lower as a percentage of net sales versus the prior year, and therefore, had a positive impact to our adjusted EBIT margin of 40 basis points. Overall, our adjusted EBIT margin increased year-over-year by 190 basis points to 15.1%.

The following chart breaks down our adjusted EPS change between our operating performance and below-the-line items. A \$0.15 impact of higher adjusted EBIT was further benefited by a \$0.02 favorable impact from lower adjusted net interest expense, a \$0.01 impact of lower adjusted taxes and a \$0.01 impact from the benefit of lower weighted average diluted shares outstanding. This resulted in adjusted EPS of \$0.70, which was up \$0.19 per share or 37% compared to prior year.

Turning to the segments. In Meals & Beverages, organic net sales, which exclude the impact from the sale of the Plum baby food and snacks business, increased 9%, driven by increases in US soup, foodservice and Prego pasta sauces, partially offset by declines in Canada.

Inflation-driven pricing and sales allowances were partially offset by increased promotional spending. Volume decreased, primarily due to supply constraints, driven by labor and materials availability and price elasticities, partially offset by retailer inventory rebuild. Sales of US soup increased 15% due to increases in both condensed and ready-to-serve soups, while broth was comparable to the prior year.

Segment operating earnings in the quarter increased 18%. The increase was primarily driven by improved gross margin performance and relatively stable marketing and selling expenses, partially offset by sales volume declines.

Gross margin performance reflected ongoing cost inflation, which was offset by pricing actions, lower other supply chain costs and supply chain productivity improvements. The lower other supply chain costs were positively impacted by the previously mentioned Texas storm impact.

Unfavorable volume/mix also pressured gross margins, largely due to reduced operating leverage as well as higher levels of promotional spending. These results also reflect lower base operating earnings in the prior-year third quarter. Overall, within our Meals & Beverages division, the third quarter operating margin increased year-over-year by 200 basis points to 19.5%.

Within Snacks, organic net sales increased 8%, while sales of our power brands were up 13%. Snacks sales increased due to increases in salty snacks, primarily Snyder's of Hanover pretzels and Kettle Brand potato chips, as well as cookies and crackers, primarily Goldfish crackers. Overall inflation-driven pricing, sales allowances and

lower promotional spending were partially offset by volume declines. Despite some inventory rebuild, volume declined in the quarter, driven by supply constraints based on materials availability and price elasticities.

Segment operating earnings in the quarter increased 25%, primarily driven by improved gross margin performance and lower marketing and selling expenses, partially offset by higher administrative expenses. Gross margin performance improved as higher inflation and increased other supply chain costs were more than offset by pricing, supply chain productivity improvements, execution improvements and cost-savings initiatives. These results also reflect lower base operating earnings in the prior-year quarter. Overall, within our Snacks division, the third quarter operating margin increased year-over-year by 160 basis points to 12.7%.

I'll now turn to our cash flow and liquidity. Year-to-date fiscal 2022 cash flow from operations increased from \$881 million in the prior year to \$1.1 billion, primarily due to changes in working capital, partially offset by lower cash earnings. Our year-to-date cash outflows for investing activities were reflective of the cash outlay for capital expenditures of \$179 million, which was down from \$190 million in the previous year.

Our year-to-date cash outflows from financing activities were \$805 million. The majority of which, or \$456 million, represented the return of capital to our shareholders, including \$340 million of dividends paid and \$116 million of share repurchases.

At the end of the third quarter, we had approximately \$425 million remaining under the current \$500 million strategic share repurchase program and approximately \$173 million under our \$250 million anti-dilutive share repurchase program. In the quarter, we settled the redemption of all \$450 million of our senior notes due to mature in August 2022 with a combination of cash and short-term debt. We ended the third quarter with cash and cash equivalents of \$196 million.

Turning to the next slide. We are raising our full year fiscal 2022 net sales guidance to reflect year-to-date performance, expectations of continued strong demand for our portfolio of brands and limited price elasticities amidst a heightened inflationary environment, as well as continued supply recovery and improved service levels.

Although our third quarter adjusted EBIT margins improved relative to the prior year, we expect core inflation to exceed prior estimates for the balance of the year. We expect margin pressure for the full fiscal year despite ongoing mitigating actions, such as net price realization, productivity improvements and cost-savings initiatives. Accordingly, adjusted EBIT and adjusted EPS performance are expected to be consistent with the guidance provided on March 9, 2022.

For the full year, we expect organic net sales to be plus 1% to plus 2%. This is a change from minus 1% to plus 1% reported on March 9, 2022. We continue to expect adjusted EBIT of minus 4.5% to minus 1.5% and adjusted EPS of minus 4% to flat versus the adjusted fiscal 2021 results. The sale of Plum is estimated to have a negative impact of 1 percentage point on fiscal 2022 net sales.

In closing, while the macro environment remains challenging and increased inflation is certain, we are confident in our outlook for the balance of the year, given the continued demand for our trusted brands and the focused execution of our teams. We are pleased with our third quarter financial results and overall business performance, and we continue to look forward to closing out the year on a strong foundation.

We will now turn it over to the operator to take your questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Andrew Lazar from Barclays. Your line is open.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Great. Thanks very much. Good morning, everybody.

Q

Mark A. Clouse

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

Hi, Andrew.

A

Mick J. Beekhuizen

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

Good morning.

A

Andrew Lazar

Analyst, Barclays Capital, Inc.

I guess, Mark, in light of recent industry chatter regarding consumer behavior shifts and retailer commentary, I thought it might make sense to start with having you address this sort of building investor notion that the pricing window has sort of, all of a sudden, effectively completely closed for the industry, which obviously is an important topic given expectations for more inflation to come in – going forward in your fiscal 2023.

Q

And I guess specific to Campbell, you mentioned the third wave of pricing was announced. Does that mean it's, sort of, locked in with key retail partners at this point? And does this pricing essentially cover what inflation you see in fiscal 2023, at least as we stand here today, or might there need to be more still?

Mark A. Clouse

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

So yeah, good question, Andrew, not surprising easier – either. But I think the first thing I just would say is, as we mentioned today, we feel very good about the execution on pricing so far through the first two waves. And then as we mentioned also today, we announced the third wave back in April. And we did that really, as you might remember in 2021, we tended to lag inflation, especially through the first couple of quarters of the year. And we wanted to make sure that we were a bit more nimble going into 2022 and really into 2023.

A

And so, as we saw the projection and the outlook for inflation, we moved very quickly to get the third wave out there. And we've been working through that with customers for really the better part of the last couple of months. And so, we've made a lot of progress on that front. And we feel very good about that as well as feeling good about how that sets us up into exiting 2022 into 2023.

I think we also feel very good about the other levers that we have and the progress we're making to help us manage the inflation, primarily, I would say, the significant step forward in our supply chain, both from a labor standpoint but also from an execution standpoint. Really nice to see the progress coming through that, that we've been working hard. And certainly, that was an area of opportunity. But as we start to think about our position

going into 2023, certainly feels much stronger of a foundation. Feels good to have that wave three pricing out there and moving.

And I think as you start to ask about future and this idea that there is no room for any more pricing, I don't think that's particularly accurate or realistic. I think what is true is that we've got to be incredibly mindful of the consumer dynamics, and where consumers are relative to the elasticities that we're experiencing and being quite strategic in our thinking about where there might be pricing and where we're at limits and probably need to think of other tools within the bag to solve for inflation.

So I certainly would hate to be sitting here today ruling out that there's no chance for further pricing. I just think we've got to be very prudent about it. And I think that's a similar sentiment that we're hearing with our retail partners. I think we're collectively wanting to make sure that we're thoughtful about where pricing is possible, where we may be seeing elasticities begin to creep up, we obviously have to be a lot more careful there.

And I think one of the topics that's starting to emerge more in these dialogues is, what are you doing to support the brands? Do you have innovation? Are we spending again on marketing and promotion? And so, as you think about our road map going forward, that's going to be an important overlay as well.

But I think from where we sit today and things that we can see on the horizon, we feel very good about the position that we're in, and how we're going to play through the balance of the year and move into 2023. Of course, we'll give you more on that when we see you next quarter. But I think for where we are today, that's probably a good assessment.

Andrew Lazar

Analyst, Barclays Capital, Inc.



Great. Thank you so much.

Operator: Your next question comes from the line of Ken Goldman from JPMorgan. Your line is open.

Ken Goldman

Analyst, JPMorgan Securities LLC



Hi. Thank you. Guidance for annual sales growth implies – I'd say, it's a fairly wide range of outcomes for your top line in the fourth quarter. So two questions on this, if I may. First, at the midpoint of that range, I think the implication is that your fourth quarter sales growth will be around 5% year-on-year. So just curious if that's a reasonable starting point to kind of think about modeling the quarter, understanding that much can still change.

And then I guess, second, could you perhaps walk us through what some of the key puts and takes might be that would lead to either, I guess, the higher or lower end of that range as you see them today? Thank you.

Mark A. Clouse

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



Yeah. Thanks, Ken. Well, I think, first off, I just would say that from a Q3 standpoint, just to give you a little bit of a frame of reference, essentially, the quarter came in very consistent where we expected to be as it related to EPS.

I think the composition in the quarter, we were a little stronger on top line and maybe a little more pressure on inflation in the middle of the P&L, but generally came in, in a profile that delivered more or less our expectations. I

think as you think about what we've put out there for the balance of the year, it kind of lives into that framework or that perspective. And that's how we're anticipating Q4 to play out.

I think you raised a good point, which is, all right, there is a range here. What would be the variables that drive the difference? And a lot of this, we think, really will come down to the ability and the speed at which we're going to continue to replenish the inventories that are in-market. Demand and elasticity, we're leaving ourselves a little bit of flexibility there. We also want some room to be able to invest in the business as we continue to move through the quarter.

The goal in mind is to try to exit the year with good momentum going into fiscal 2023. But I think a lot of the variability that you see in that range will depend on just how quickly we recover in a couple of these areas on that top line. I think this kind of mid-single-digit area for kind of that midpoint for top line is a good place to be.

Ken Goldman

Analyst, JPMorgan Securities LLC



Great. Thanks very much.

Operator: Your next question comes from the line of Peter Galbo from Bank of America. Your line is open.

Peter T. Galbo

Analyst, Bank of America



Hey, guys. Good morning. Thanks for taking the question. Maybe if I can just ask a follow-up to Ken's question, kind of, Mark, similar to the bottom line, I think there's a pretty wide range of EPS outcomes as well. And I think you mentioned investment and leaving yourselves some room to invest in the business. But anything that would kind of drive it at the higher or lower end of that EPS range at the bottom?

And then maybe, Mick, just thinking about the chart you have on core inflation. I guess, as we think about it over the next few quarters, that's obviously going to have a pretty material step-up, it seems like in the fourth quarter. But then, does that rate of change going into the first half of next year kind of start to level off wherever, maybe mid – high-teens, low-20s? Just any color there would be helpful. Thanks, guys.

Mark A. Clouse

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



Yeah. So on the bottom line guidance range, I do think it is linked pretty intrinsically with the top line. So as you move the top line to the higher ends of the range or the lower ends of the range, those tend to coincide pretty directly. So I see that as a little bit more perhaps of where the variability is.

I think, again, to reinforce what I said before, I also think that as we've thought about this fourth quarter, we do want to see, as supply comes back in, as our distribution recovers, as we're on a much stronger footing for supply in general, part of this is returning the marketing and the promotion spending to the business so that we're able to continue to drive that strength of equity, especially in face of some of the pricing and elasticities that we're navigating. And so, I think giving ourselves a little bit of room there is the smart play right now. And again, the goal in mind is to really try to leave the year in a very positive position as we move into 2023.

And then, Mick, I'll let you answer the second one.

Mick J. Beekhuizen

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

A

Yeah. No. And I think with regard to inflation, you obviously saw the uptick with regard to inflation between the second quarter and the third quarter. And particularly, that's also related to the fact that you have some of our contracts that are reset on a calendar year basis, and we spoke about that obviously in the past.

So you see that we expect – when I look kind of throughout the quarterly progression of inflation, as Mark mentioned earlier, we follow that very closely. And as a result, as Mark also described, one of the decisions that we made is the announcement of the wave three pricing. So in order to make sure that we continue to track and help offset is one of the different tools in our toolbox, the inflation that we see coming.

Mark A. Clouse

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

A

Yeah. And of course, that would anticipate that outlook into the first half of certainly of 2023.

Peter T. Galbo

Analyst, Bank of America

Q

Got it. Thanks very much.

Operator: Your next question comes from the line of David Palmer from Evercore. Your line is open.

David Palmer

Analyst, Evercore ISI

Q

Thanks. Just a general question, maybe you can answer on behalf of the food space is something we're wrestling with. When we look at consumer panel data, it looks like the under \$60,000 household income consumers drove outsized growth during COVID, seemingly at the expense of private label brands gaining share. And then, of course, fast food restaurants suffered during that time as well from a traffic perspective. And these lower to middle income consumers tended to skew younger as well, which could be good news because that's a lot of trial.

I'm wondering if your consumer – does your consumer data show this as well. And I'm wondering how you're feeling about repeat levels. And are these plans to kind of keep these younger and lower income consumers in the tent in your brands as perhaps mobility increases and private label becomes more available? Thanks.

Mark A. Clouse

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

A

Yeah. So a lot to unpack there, but a very important question. So what I would start with is just by saying to you that I think, and I've said this consistently and I'll give you a couple of real-time examples, is that our portfolio is very well-positioned and resilient as it relates to challenging economic environments however you might categorize that.

And so, a lot of times, what we – the dynamic that we see is – yes, let's take condensed soup as an example, where we are seeing and expected to see some pressure from private label, you also have significant migration of trading down into the category, so that the overall category growth rates are up pretty significantly. And volumes are holding up very well even in the face of pricing that can be double digits so far that we've seen.

I think what's been new about this or what's been a little bit more unique than maybe what we've seen in the past is where we're experiencing more of the trade down tends to be more in the baby boomer, little bit older consumer that tends to be a bit more price-sensitive. And we're picking up a lot of these new consumers as they are moving into the category.

Another great example of that is Chunky. Chunky's pricing is up mid-teens right now. And what we're learning is, although that seems like a lot of pricing, and it is, but for a can of soup, it's still under \$3. For a large part of the population trading down into the ready-to-serve soup category becomes a very economic move for them. And that's why on Chunky, we see right now, pricing mid-teens, consumption's up 14%, but units are still up 3%. And our volume was up 8% in the quarter. So you've got a very, very healthy dynamic that exists in several of our brands. And I'd say it's not far off for categories like Prego or pasta sauce.

And even on the Snacks side, it tends to be a little bit more in the – I'd say, in the more indulgent spaces, like cookies and some of our salty snacks. But the elasticities have been very, very low. And historically speaking, those are categories that you tend to think of as discretionary, but tend to hold up very well. Remember, backstopping all of this discussion is an overarching migration from away-from-home into home, and the idea that eating at home is one of the enablers to combat pressure as it relates to economic challenges.

And so, I think, look, it's complicated because every category and brand is a little different. And that's the way you've got to go at this. So it's not as simple as answering it in a broad stroke. But as we look at our portfolio, certainly, we feel very good about how we're positioned today as well as heading into the environment ahead. And I think, certainly, the evidence that we've seen so far is that there's probably even some more reasons to be encouraged than what we would have seen historically.

And all of that is caveated with the appropriate amount of vigilance here to make sure that if we do find ourselves in a position where elasticities begin to really accelerate, that we've got the appropriate contingency plans and support plans to navigate through it. So again, there's not a really singular answer for it. But I do think as it relates to Campbell, we feel that we're positioned very well. But we'll, of course, continue to be highly aware of what's going on around us.

David Palmer

Analyst, Evercore ISI

Q

Thank you.

Operator: Your next question comes from the line of Nik Modi from RBC Capital Markets. Your line is open.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Thanks. Good morning, everyone.

Mark A. Clouse

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

A

Hey, Nik.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

So I just had a quick clarification in terms of the shortage of materials. Can you just provide just more details around that? But my broader question is just on [ph] trapped (51:08) costs. If you think about all the excess costs that you guys have incurred during COVID as a result of retailer penalties and just supply chain issues, can you just give us any context on the magnitude of those costs?

And as kind of things normalize, I know this – it might take some time for this to normalize. But as you think about these costs and the normalization, would that just drop to the bottom line? Or philosophically, would you say, look, we've got to build some capabilities to deal with future shocks like this, so maybe we should reinvest in relocating supply chains or diversifying our supplier base, what have you? Any thoughts on that would be helpful.

Mark A. Clouse

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

A

Sure, Nik. That's great point. I think the first step for us was really – let me answer the second one first, and then I'll come back to the materials question. But I think the first step for us was to make sure that we had the appropriate labor and staffing to run our plants in their current configuration and current state.

And so, I think the team did an amazing job in a very difficult labor environment to recover on that front and to significantly improve retention. And it's a full kind of toolbox, full of things that were applied to get that job done. And I do think that's an area where we improved quicker than we had even expected. And that really enabled us to begin to get that service and distribution and start to replenish some inventory very quickly.

Now with that in place, as we start to operate on a more steady state for the supply chain, it's now an opportunity to go after a lot of these areas of productivity. And some of it is, I think, it's coming from a couple of different areas. I think one of the areas is certainly looking back and saying, okay, where were the inefficiencies that we may have given up over the last year and how do we build the right road maps to recover that. In many ways, I see that as the easier, the lower-hanging fruit, to go after. And I do think you'll see a meaningful productivity profile as we go into the next year to support that.

And then secondarily, I think we have not been standing still on capabilities throughout this whole process. And perhaps some of the challenges we faced were maybe biting off a few too many of those initiatives at the same time in the past. But now it's paying dividends, right? So now we have new capacity in place that's more efficient capacity. We've got capabilities where the entire company is on a singular system with SAP now. These are incredibly important aspects in your supply chain that enable you to build future productivity. And so, that's why when we say, how do you feel about the inflation coming forward? Yes, pricing is certainly a pivotal component of it, but there are a lot of other variables.

And at the end of the day, what we're really trying to do is, honestly, keep prices as reasonable as we possibly can, right? We know the pressure that consumers are feeling. And so, the more that we can do on that productivity side, the better off we're going to be. And so, the emphasis there and focus there is quite significant. And perhaps, this quarter, more than anything else to me, was the proof point of being able to get back on both feet with the supply chain. That's such a critical step in creating the reasons to believe going forward. And I just feel like that's going to be an enabler for us to do a lot of things in the future.

As it relates to material availability, so when we talked about supply chain challenges in the third quarter, I would really cut that into two buckets. One was the labor and just the network yield, right, the ability to produce out of our existing network, enough product to match demand. For the most part, that we've now recovered on or we'll be recovering very shortly through the next months or so.

On the other side of supply challenges is material availability. That is far more concentrated into a couple specific places, probably most notably on both our Prego business as it relates to certain flankers or SKUs and our beverage business, in particular, where we continue to really fight for aluminum cans. That continues to be one of the toughest materials to recover from. I don't think it's an endless stream. I think there is light at the end of the tunnel for those. But my guess is that those will probably take us into the better part of 2023 to fully recover on those.

And then, of course, there's always odds and ends here and there. And I think we've done a very good job of creating some flexibility in packaging and formulation to allow us to not necessarily be solely dependent on single sourcing. But I think at the end of the day, we've got a couple that will probably linger with us while the network more or less fully recovers.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Very helpful, Mark. Thank you.

Operator: And your final question comes from the line of Jason English from Goldman Sachs. Your line is open.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Hey, folks. Thanks for slotting me in.

Mark A. Clouse

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

A

Hey, Jason.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Congrats on the progress you're making on loosening up the supply chain. I wanted to talk, rather than the supply chain and costs, more on the investment side. The business had found itself in a fair amount of difficulties and problems in fiscal 2018, which obviously led to a rebase in fiscal 2019 to reinvest. You've kind of – it looks like on the surface, you've now taken all that incremental investment and pulled it back out of the business. On a trailing four-quarter basis, your marketing and selling expense is pretty much matching fiscal 2018 despite underlying inflation.

Mark, how do we get comfortable with this level of spend? What is the right level of spend? And should we be expecting another rebase to restore that and get your market share back in growth?

Mark A. Clouse

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

A

Yes. Good question, Jason. So let me first talk a little bit about where we sit today. So as we think about the spending profile that we're at, so marketing and sales for the quarter was about 8.8%. And as you've heard me say before, I'm a lot more comfortable with that around 10%, in the 9% to 10% range, depending on a couple of variables relative to inflation – or innovation and other sources of investments.

So there is no question that where we are today, we would want to move up from. I don't think it represents any kind of rebase like we would have experienced because a lot of that was about repositioning, reframing a lot of categories that we were moving away from or shifting to. This is really about, in the broader scheme of things, the difference between that 8.8% and where we want to move to over time.

I think what's important to note is the A&C retraction has really been singularly minded on where the supply is. This is not simply a tool to try to hit profitability. It was really designed to reflect where we just don't have – didn't have the supply to support. And so, shaping demand a bit through pulling back on some of that spending.

As you think about or as we think about our future plans, we've contemplated that. And so, as we see recovery in supply and supply chain, I would expect to see that number begin to move forward. And again, I don't think it has to be any type of big bang. But I think as we move from 8.8%, up the ladder a bit, I think we can begin to do that. And you should expect to see that as part of the ongoing plan as we move forward. Of course, I think that'll – again, it will follow very closely as we recover fully in supply. We do have a robust innovation pipeline we talked about today. So we expect to fully support that.

So I guess what I would say is, there's no question there's been a step back. I think really, again, related much more to supply than necessarily trying to target it for savings. But as we move forward, I think, in a very thoughtful and kind of pay-as-you-go mindset, we would expect to see that recovering over the next quarters and certainly into 2023.

Jason English

Analyst, Goldman Sachs & Co. LLC



Okay. Thank you. I appreciate it.

Operator: And this concludes our question-and-answer session. I will now turn it back over for some final closing comments.

Rebecca Gardy

Senior Vice President & Chief Investor Relations Officer, Campbell Soup Co.

Thank you so much for joining us today. I think as you saw in our press release earlier, we will be attending the Deutsche Bank conference next week. And if you have any questions, please feel free to reach out to me at Investor Relations. Thank you so much.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.

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