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CPB - Q4 2016 Campbell Soup Co Earnings Call

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OVERVIEW:

Co. reported 4Q16 as-reported net sales of $1.687b and adjusted EPS of $0.46. Expects 2017 sales growth to be 0-1% and adjusted EPS to be $3.00-3.09.

CORPORATE PARTICIPANTS

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

Denise Morrison *Campbell Soup Company - President & CEO*

Anthony DiSilvestro *Campbell Soup Company - SVP & CFO*

CONFERENCE CALL PARTICIPANTS

Ken Goldman *JPMorgan - Analyst*

Bryan Spillane *BofA Merrill Lynch - Analyst*

David Driscoll *Citi Research - Analyst*

Jason English *Goldman Sachs - Analyst*

Robert Connor *Credit Suisse - Analyst*

Matthew Grainger *Morgan Stanley - Analyst*

John Baumgartner *Wells Fargo Securities - Analyst*

David Palmer *RBC Capital Markets - Analyst*

Mario Contreras *Deutsche Bank - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Campbell Soup fourth-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. Please go ahead.

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

Thank you, Stephanie. Good morning, everyone. Welcome to the fourth-quarter earnings call for Campbell Soup's fiscal 2016. With me on the call are Denise Morrison, President and CEO, and Anthony DiSilvestro, CFO.

As usual we have created slides to accompany our earnings presentation. You will find the slides posted on our website this morning at investor.CampbellSoupCompany.com. This call is open to the media who participate in 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.

Now I'd like to remind you about items impacting comparability. As we said in this morning's news release, the current quarter results reflect a non-cash impairment charge, pension and postretirement mark-to-market losses and charges related to cost savings initiatives.

The prior year quarter included pension and postretirement mark-to-market losses and charges related to the implementation of the new organizational structure and cost savings initiatives. The adjusted results exclude the impact of these items impacting comparability and our comparisons of the full-year 2016 with 2015 will exclude these and previously announced items.

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

Lastly, please mark your calendars for our planned fiscal 2017 earnings dates. We plan to release earnings on November 22, 2016; February 17, 2017; May 19, 2017; and August 31, 2017. 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 fourth-quarter earnings call. Today I will offer my perspective on our performance with a focus on how each of our divisions are performing against their portfolio roles.

We finished the year in line with our guidance and with strong profit performance. However, our results this quarter certainly did not meet my expectations. I am particularly unhappy with the short-term executional issues that have led to the poor performance in Campbell Fresh, both for the quarter and for the year. I will spend the majority of my time this morning addressing this topic.

While sales for the year, including Garden Fresh Gourmet, were up 5%, organic sales declined 4% in C-Fresh. In the fourth quarter organic sales were down 12% driven by declines in both CPG and Farms. This performance is unacceptable; I expect far more from the Campbell Fresh business.

It is clear that we have several immediate challenges in Campbell Fresh and we are addressing them. I will get to that in a moment; but first I want to step back and look at the big picture.

As a reminder, fiscal 2016 is the first year of operation of Campbell Fresh. This division, which accounts for approximately $1 billion in revenue, or about 13% of our total sales, combines Bolthouse Farms, the Garden Fresh Gourmet acquisition and our refrigerated soup business.

Strategically, C-Fresh positions Campbell to benefit from the growing health and well-being trend as well as the growing demand for better-for-you foods in the Packaged Fresh category. Its portfolio role is to deliver full force growth driven by the CPG business and to contribute to the acceleration of Campbell's overall sales trajectory.

While disappointed in our execution, I remain confident in our C-Fresh strategy. We have strong popular brands that are on trend with the changing nature of consumers' eating habits. We are well-positioned in the produce and deli section of stores with an eye on expansion into other categories such as dairy. We have a robust innovation pipeline and we are enhancing our approach to long-term innovation.

Strategy was not the issue. Our problem was execution. I'm going to spend some time on what didn't work and, importantly, the actions we are taking to ensure the business performs to its potential.

So, what went wrong? There were two issues that were the primary drivers of the C-Fresh results in the quarter: the Bolthouse Farms Protein PLUS recall and the poor performance of our carrot business. Let's start with our CPG business and the Bolthouse Farms recall and related production outage.

As previously announced on June 22, we voluntarily recalled 3.8 million bottles of Bolthouse Farms Protein PLUS beverages due to possible spoilage. The Protein PLUS lineup accounts for approximately 15% of the Bolthouse Farms beverage business. In addition, the same manufacturing lines are used to produce our cafe drinks which account for another 10% of the beverage business.

Our examination into the recall identified our manufacturing equipment and process as the primary cause of the spoilage. We have corrected these problems, rigorously tested the product and started shipping again. However, production has not returned to the pre-recall levels due to new operating procedures that we have put in place, including an enhanced test and release protocol to ensure the product meets our high quality standards.

Prior to the recall a typical production run for these products would have been 72 hours, today a production run is 24 hours. Unfortunately the shorter runs significantly reduce our capacity. We are examining various ways to increase capacity including commissioning other production lines, but we currently anticipate these will take time to implement and expect that supply will be impacted through the end of the calendar year 2016.

Now turning to Farms. Let's take a look at our second issue, our carrot business. In July at our Investor Day we discussed some weather-related problems and a customer issue in our carrot business. As we review these issues further, we learned the problems were rooted in several decisions that had compounded one on another and therefore were broader than we understood at the time.

Specifically, there were some planting, harvesting and commercial decisions made earlier in the calendar year that exacerbated the weather problems. This led our Farms operation to harvest carrots prematurely in an attempt to meet customer demand. Ultimately this resulted in a spring crop that yielded smaller carrots which led to customer dissatisfaction and an additional loss of business.

The size of the carrots we are harvesting now is vastly improved and we are actively addressing service issues with customers. However, it will take us time to regain the lost business. As a result we now expect fiscal 2017 carrot sales to be comparable to fiscal 2016 rather than benefiting from a recovery from last year's issues.

A final point of context, carrots are a relatively low margin business. However, it serves as the chassis for our higher margin value added CPG business. Carrots provide the scale for the refrigerated logistic system that we leverage for distribution and merchandising.

So, what actions have we taken so far to correct these issues? Over the last several weeks we made major organization changes under Jeff Dunn, the President of Campbell Fresh. Several senior managers are no longer with the Company including the President of Bolthouse Farms.

Additionally, we created a new structure to foster more agility and collaboration across the division. Previously we had two operating units; Bolthouse Farms functioned as a distinct unit and Garden Fresh Gourmet was combined with fresh soup.

Now we have three operating units reporting directly to Jeff: CPG, which integrates Bolthouse Farms' beverages and salad dressings with Garden Fresh Gourmet salsa, hummus and chips along with fresh soups; Farms, which consists of carrots and carrot ingredients; and the long-term innovation unit we discussed at Investor Day in July.

In addition to the three operating units, we have created a more integrated structure both at the division level and with Campbell. In particular, we have strengthened the integration and oversight of the Campbell Fresh supply chain. We have also bolstered the Campbell Fresh leadership team by adding more senior finance, human resources and sales executives.

This new team is a combination of seasoned and accomplished Campbell and Bolthouse Farms leaders and experienced executives recruited from food startups and major industry players. I believe that this newly structured team will lead this business back to the growth profile mandated by its portfolio role.

In the first half of fiscal 2017 that new management team will take steps to stabilize the business. First, we expect to improve our execution. Second, we plan to continue to increase capacity as we rebound from the Protein PLUS recall and related production outage. And third, we will stabilize the carrot business through improved quality and customer service.

Our plans call for C-Fresh sales to be down slightly in the first half and return to growth consistent with its portfolio role in the second half. Putting it all together, we expect sales growth to be in the low-single-digits for fiscal 2017 and we will keep you updated on developments as we go.

While disappointed in the near-term performance of C-Fresh, I remain confident in the strategy we are pursuing, the Packaged Fresh platform we are building and the growth potential of this business. Now let me shift gears to the progress we have made in other areas during fiscal 2016.

As I said earlier, when I look at the year as a whole for the Company, our profit performance was strong. This was driven by our Americas Simple Meals and Beverages and Global Biscuits and Snacks divisions. We delivered double-digit adjusted earnings growth with solid operating performance including expanded gross margin, significantly improved supply chain performance and better than expected cost savings.

We also advanced our real food and transparency agenda establishing Campbell as a leader in this area. However, we continue to face challenges on the top line. We recognize that we need to grow sales and it remains a top priority.

Our Americas Simple Meals and Beverages and Global Biscuits and Snacks divisions have performed largely in line with their portfolio roles.

First, Americas Simple Meals and Beverages, things are moving in the right direction here and I feel good about what we have achieved this year. We made important strides in fiscal 2016. The team drove significant gross margin expansion through a combination of net price realization and major improvements in our supply chain. This resulted in a 13% increase in operating profit.

Our Simple Meals brands delivered sales growth behind Prego and Pace, and Plum delivered double-digit sales gains through increased distribution and innovation. And we advanced our real food agenda changing many of our recipes including clean label products and embracing transparency.

While we have accomplished much in the Americas divisions, sales remain inconsistent. Organic sales declined 1% for the year. Many of our brands are performing in line with the categories in which we compete. However, portions of the portfolio are underperforming their categories, in particular beverages and ready-to-serve soup. We are taking steps to address this and expect to improved performance in these areas and modest growth in the division in fiscal 2017.

Looking ahead, the Americas division will continue to concentrate on getting more from our core brands with a focus on driving sales through investments in fewer, bigger innovations and improve marketing while increasing margins. We have plans in place to drive continued margin expansion through supply chain efficiencies.

In fiscal 2017 we expect our soup business to grow behind continued growth of broth and better performance from our ready-to-serve soup portfolio. As we outlined at Investor Day, our plans call for improved execution around the Chunky brand and the midyear launch of the new Well Yes! clean label soup line.

We also anticipate better performance from V8 beverages driven by the continued success of Veggie Blends and V8 +Energy, as well as a renewed focus on tried and tested marketing that re-engages our loyal V8 Red consumers. To connect with our consumers, build brand relevance and drive demand we are investing in four integrated marketing campaigns in the Americas including a new NFL themed Chunky campaign featuring six popular players.

For the year our Global Biscuits and Snacks division made progress in performing against its portfolio role. Organic sales increased 1% and operating earnings were up 10%. Pepperidge Farm delivered strong performance and our Asia-Pacific team drove solid sales results in a highly competitive and concentrated trading environment.

The emphasis on growing our icon brands, Goldfish, Tim Tam, and Milano, as well as revenue management initiatives and improved supply chain performance drove our results.

Looking ahead, we remain focused on delivering the division's role of expanding in both developed and developing markets while improving margins. In the United States we have higher levels of investment to drive sustained Goldfish growth, continued momentum for Milano, expanded Tim Tam distribution and increased innovation in our fresh bakery business.

In Australia, we are focused on strengthening our Arnott's brand through integrated marketing and relevant consumer driven innovation. In developing markets we expect continued growth in Malaysia and improved performance in China and Indonesia.

Looking forward to 2017, I have a pragmatic outlook. Our plan calls for modest growth driven by reinvesting some of our cost savings back into the business. We are confident in the C-Fresh platform and we are acting with urgency to address our execution to get the beverage and carrot business back on track while continuing to drive sales on salad dressing, Garden Fresh Gourmet salsa, hummus and fresh soup.

We expect Americas Simple Meals and Beverages and Global Biscuits and Snacks to continue to live into their portfolio roles. We remain focused on delivering our three-year cost savings target and we are looking for more opportunities to drive effectiveness and efficiency.

We will be reinvesting a portion of our cost savings in focused innovation and improved marketing on our core business. And we are creating an ownership mindset across the organization through our zero-based budgeting efforts. These are reflected in our annual guidance which Anthony will take you through in a few minutes.

Clearly we have some challenges ahead of us, but we know what is working and what is not and we are taking action to improve our sales performance in every division. I remain confident in the strategic imperatives that we are pursuing and that they provide a compelling path to increase shareholder value. Reflecting confidence in our growth prospects and the strong profit performance this year, our Board of Directors declared a 12% increase in our quarterly dividend.

Thank you. I look forward to answering your questions and a few minutes. Now let me turn the call over to our Chief Financial Officer, Anthony DiSilvestro.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Thanks, Denise, and good morning. Before getting into the details I want to provide my perspective on our results and guidance. As Denise stated, we are disappointed with the performance of our C-Fresh division in the fourth quarter, which was the key driver of a 1% decline in organic sales for the Company reflecting the recall of Bolthouse Farms protein drinks and declines in carrots.

At the EBIT line, the negative impact of the C-Fresh performance was offset by lower incentive compensation accruals relative to our expectations. In the fourth quarter our adjusted tax rate was negatively impacted by a $13 million correction for deferred taxes. The correction had a negative impact on EPS of $0.04 per share and, as a result, our full-year tax rate finished above our previous expectations.

Moving on to the full year, while adjusted EPS of $2.94 was within our guidance range, we finished at the lower end due to the tax correction. We are pleased with our gross margin performance, which on an adjusted basis increased by 170 basis points, in line with expectations, driven by significantly improved supply chain performance, cost savings and net price realization.

We continue to make very good progress against our three-year cost savings target of $300 million delivering about $130 million of incremental savings in fiscal 2016, bringing the program-to-date total to $215 million.

As part of our annual review of intangible assets we recorded a non-cash impairment charge of $0.41 per share in our GAAP results on our Bolthouse Farms carrot and carrot ingredient business, reflecting reduced expectations for future cash flows. I am very pleased with our strong cash flow performance as cash from operations exceeded $1.4 billion and our Board has approved a 12% increase in the quarterly dividend.

Looking ahead to fiscal 2017, although below our long-term target, we plan to improve our sales performance compared to 2016 and make investments in the business to support key brands, launch new products, drive long-term innovation and build capabilities in areas like digital and e-commerce.

Now I will review our details -- sorry, our results in more detail. For the fourth quarter net sales on an as reported basis of $1.687 billion were comparable to the prior year.

Excluding the negative impact of currency translation and the favorable impact of the Garden Fresh Gourmet acquisition, organic net sales declined 1% driven by declines in Campbell Fresh, partly offset by gains in Global Biscuits and Snacks. The negative impact from the Bolthouse Farms recall and related production outage was approximately 1 percentage point on total Company sales.

Adjusted EBIT declined 2% to $253 million as higher advertising and consumer promotion expenses and a lower gross margin percentage were partly offset by lower administrative expenses reflecting lower incentive compensation accruals.

Adjusted EPS decreased 6% or $0.03 to $0.46. This EPS decline includes a $0.03 per share negative impact from the Bolthouse Farms recall and related production outage, consistent with our expectations, as well as the $0.04 per share negative impact from the tax correction.

For the full year as reported and organic net sales both decreased 1% compared to the prior year. Adjusted EBIT of $1.467 billion and adjusted EPS of $2.94 both increased by 11%. Earnings growth is being driven by our improved gross margin performance and the benefits from our cost savings initiatives.

Breaking down our sales performance for the quarter, net sales was comparable to prior year. Organic sales declined 1% as a 2 point negative impact from higher promotional spending was partly offset by a 1 point gain from volume and mix.

Gains in volume were driven by growth in Arnott's biscuits, Pepperidge Farm Goldfish crackers and Prego pasta sauces, which benefited from the launch of the new Prego Farmers' Market product line, partly offset by declines in C-Fresh due to the Bolthouse Farms protein drinks recall and volume decline in carrots.

Increased promotional spending across our three segments includes higher spending in Arnott's as we're lapping an unusually low quarter which was impacted by product availability, higher spending in Bolthouse Farms to remain competitive and support the launch of 1915, and higher spending on Prego and Pace. With the exception of C-Fresh, increased promotional spending drove gains in volume.

Completing the bridge, a 1 point negative impact from currency translation was offset by the 1 point benefit from the acquisition of Garden Fresh Gourmet.

Our gross margin declined 90 basis points in the quarter to 36.1%. Looking at the drivers of the decline, cost inflation and other factors had a negative impact of 270 basis points driven primarily by: cost inflation, which on a rate basis increased by about 1.5%; the recall and related production outages of Bolthouse Farms protein drinks; and higher carrot costs from unfavorable crop yields.

Reflecting the increased promotional spending on the businesses I mentioned in the sales discussion, the higher promotional rate had a negative impact of 110 basis points on gross margin. This was partly offset by list pricing gains of 20 basis points from previous pricing actions in Global Biscuits and Snacks. Mix was slightly favorable, also adding 20 basis points.

Lastly, our supply chain productivity programs, which are incremental to our three-year cost savings program, contributed 250 basis points of margin improvement in the quarter. Looking at this another way not on the chart, the weak performance of the Campbell Fresh segment accounted for 70 basis points of the total decline of 90 basis points including the protein drink recall which accounted for 50 basis points.

Adjusted marketing and selling expenses increased 14% in the quarter, primarily due to higher advertising expenses in Pepperidge Farms to support Goldfish crackers and the fresh bakery business and increase support of Prego pasta sauces. Adjusted administrative expenses decreased 19% primarily due to lower incentive compensation cost which account for about two-thirds of the decline, as well as the benefit from our cost savings initiative.

For additional perspective on our performance, this chart breaks down our EPS change between our operating performance and below-the-line items. Adjusted EPS decreased $0.03 from $0.49 in the prior year to $0.46 per share in the current quarter. On a currency neutral basis declines in adjusted EBIT had a negative impact on EPS of $0.01.

Our adjusted tax rate for the quarter increased by 2.3 points to 36.4%. The increase in the tax rate reduced the EPS by $0.02 as the impact of the deferred tax correction was partly offset by the benefit of geographic mix.

The impact from share repurchases under our strategic share repurchase program reduced our share count slightly, but due to rounding shows no benefit on EPS in the quarter.

Interest was fairly comparable to prior year, up $1 million, with no impact on EPS as the impact of higher average interest rate from the debt portfolio was mostly offset by lower debt levels.

Currency translation also had no impact, completing the bridge to $0.46 per share.

Now turning to our segment results. In Americas Simple Meals and Beverages, organic sales were comparable to prior year at $842 million driven by double-digit gains in Prego pasta sauces, including the benefit of the launch of Prego's Farmers' Market, and also by double-digit gains in Plum products offset by declines in V8 beverages and ready-to-serve soup.

Operating earnings increased 4% reflecting a higher gross margin percentage driven by productivity improvements, partly offset by increased marketing expenses as we've increased support behind Prego and V8 beverages.

Within US Soup, which declined 2% in aggregate, condensed declined 1% and RTS declined 6%. These declines were partly offset by a 7% gain in Swanson broth. Estimated changes in retailer inventory levels did not meaningfully impact soup sales in the quarter.

As we've previously stated, while we will discuss the key drivers of soup performance as we do with our other businesses, this is the last quarter we will provide detailed subcategory sales performance.

Here is a look at US wet soup category performance and our share results as measured by IRI. For the 52-week period ending July 31, 2016, the category as a whole declined by 2.7%. Our sales in measured channels declined 3.8% primarily driven by weakness in ready-to-serve, partly offset by strength in broth.

Campbell had a 59% market share for the 52-week period declining 70 basis points. Private label grew share by 10 basis points finishing at 13%. All other branded players collectively had a share of 29%, up 60 basis points reflecting share gains by smaller brands.

In Global Biscuits and Snacks, organic sales increases 2% with double-digit gains in Pepperidge Farm Goldfish crackers supported by increased advertising and growth in Arnott's biscuits in Australia and New Zealand driven by increased promotional activity.

Operating earnings increased 5% to $81 million as lower administrative costs were partly offset by a lower gross margin percentage. Within gross margin, the impact of cost inflation and increased promotional spending was partly offset by productivity improvements.

In the Campbell Fresh segment organic sales decreased 12% reflecting declines in Bolthouse Farms' premium refrigerated beverages due to the recall of protein drinks. Sales of the CPG beverages and salad dressings business declined 10% in the quarter.

Sales of carrots also declined as we experienced quality issues in the fourth quarter which led to customer dissatisfaction and the loss of business. These declines were partly offset by gains in fresh soup.

Operating earnings declined by $13 million or 62% to $8 million primarily driven by the adverse impact of the voluntary recall on Bolthouse Farms protein drinks and related production outages as well as higher carrot costs and lower sales of carrots and carrot ingredients partly offset by lower administrative expenses.

Just a reminder that Garden Fresh Gourmet was acquired on June 29, 2015 and we have now wrapped the acquisition date. As a result there is one month of operating results from Garden Fresh Gourmet now included in organic sales.

We had very strong cash flow performance of fiscal 2016. Cash from operations increased by $281 million to a record $1.463 billion driven by significantly higher cash earnings and lower working capital requirements reflecting reductions in inventory level.

Capital expenditures declined $39 million to $341 million. We paid dividends totaling $390 million, reflecting our current quarterly dividend rate of $0.312 per share. And as announced this morning we will be increasing our quarterly dividend by 12% to $0.35 per share.

In aggregate we repurchased $143 million of shares in fiscal 2016, $100 million of which were under our strategic share repurchase program. The balance of the repurchases remained to offset dilution in equity-based compensation. Net debt declined by $592 million as cash from operations was well in excess of capital expenditures, dividends and share repurchases.

Now I will review our 2017 outlook. The Company expects sales to grow by 0% to 1%, adjusted EBIT to grow by 1% to 4%, and adjusted EPS to grow by 2% to 5% or $3.00 to $3.09 per share. This guidance assumes, based on current exchange rates, that the impact from currency translation will be nominal.

While not to the level of our long-term sales growth target of 1% to 3%, sales performance is expected to improve relative to 2016 as we address those businesses which have underperformed.

While we expect to achieve further EBIT margin expansion in 2017, growth in adjusted EBIT is slightly below our long-term target as we will be making investments in our business to support key brands in new product launches, in long-term innovation and to build capabilities in areas like digital and e-commerce. These investments are designed to improve our growth profile over the long-term.

Our range for growth in adjusted EPS is ahead of EBIT as we plan to increase share repurchases and benefit from a slightly lower tax rate, partly offset by slightly higher interest expense given our expectation of rising short-term interest rates.

While we don't give quarterly guidance, I will say that we expect the majority of our top- and bottom-line growth to come in the second half as we work through the issues we are currently experiencing in C-Fresh and as we wrap lower levels of marketing support in the first half of fiscal 2016.

Turning to some of the key assumptions underlying our guidance. While inflation on core ingredients and packaging has moderated, we expect inflation and cost of products sold of approximately 2%, including higher wage and ongoing benefit costs and a lagging negative impact of a stronger US dollar on the input costs of our international businesses given the timing of our foreign currency hedges.

As we have successfully delivered in the past, we expect ongoing supply chain productivity gains, excluding our ZBB initiative, of approximately 3% of cost of products sold. We expect our gross margin percentage to improve slightly with productivity gains exceeding inflation. The effective tax rate is estimated to be approximately 32%, slightly below the 2016 adjusted rate of 32.6%.

While we are not prepared to provide a specific amount, we currently plan to significantly increase share repurchases unless needed for other uses including M&A. Our EPS guidance reflects the favorable impact of these anticipated repurchases over the course of the year on our average shares outstanding.

We are forecasting capital expenditures of approximately $350 million, comparable to fiscal 2016 levels and in line with our historical spending level. And under our cost savings program we expect to deliver incremental savings of $50 million in fiscal 2017 and are on track to achieve our $300 million goal by 2018.

That concludes my remarks. I will turn it back to Ken for the Q&A.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Ken Goldman, JPMorgan.

Ken Goldman - *JPMorgan - Analyst*

I wanted to get a bit of a better understanding of the carrots business longer-term from here. I do understand, Denise, that there were some execution issues. I think that indicates that perhaps a lot of the problem is fixable. You also talked about carrot yields which suggest that is fixable too.

On the other hand, you just took a big write-down, and I would look at that as maybe an indication that the business is never going to be as strong as it once was, or at least in management's mind. So, I really just wanted to get a better sense of maybe how to balance those two data points, I guess, as we think about not just 2017 but beyond for the carrots business.

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

Yes, I think that, as we indicated, the carrot business is right now going through a short-term issue. And fortunately it is a short-term crop and the crop we are harvesting now is much better. So we believe we will be back in business at pretty normal levels by about the second half of the year. We have got a lot to do there; I mean we have got customer issues to address and we are actively doing that.

Going forward I think as we look at the business, based on the growth rates in sales and earnings that we saw when we bought the business, we believe that the growth rates are going to be about flat to up slightly. And that is a little bit more conservative than when we first bought the business.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Yes, if I could just add to that. As part of our annual testing of intangible assets, which we perform in the fourth quarter, we do a detailed discounted cash flow analysis. And as we performed that on the carrot and carrot ingredient reporting unit we certainly reflected the current year performance and our expectations for future cash flow. And while we expect the performance to improve over time, it is not to the levels previously anticipated and consequently it has led to the impairment charge.

Ken Goldman - *JPMorgan - Analyst*

Okay, that makes sense. Can I ask one quick follow-up? Denise, you mentioned -- and maybe I heard you wrong -- that you wanted to get C-Fresh into other areas. And I think you mentioned dairy. I had always thought the goal was maybe to get into dairy alternatives not necessarily dairy itself. I am just curious if there was a change at all in your thinking there?

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

Yes, Ken, that actually is related to what we talked about at Investor Day with -- in our long-term innovation group working on the new pea protein beverage. So, it is plant-based beverages but they would be situated in the dairy part of the perimeter of the store.

Ken Goldman - *JPMorgan - Analyst*

Okay, thanks for the clarification.

Operator

Bryan Spillane, Bank of America.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Just a follow up on Campbell Fresh. I guess as we look at Bolthouse going into 2017 just two points I guess I would like to get some clarification on. First, in terms of the profitability there for this year, I guess it sounds like it will be somewhat impaired or below what a normal run rate would be as you sort of rebuild your production capacity and you get -- rebuild the customer base in carrots.

I just want to make sure that that is one of the things that will hold it back this year maybe relative to what we should expect in 2018 and 2019, it is just simply there is a little bit of rebuilding that has to go on.

And then as a follow-up to that, just does the sort of adjustments you are making in production runs and run times -- sounds like maybe even considering new production lines. Does that at all slow the pace of new product innovations like the pea protein drinks? Just trying to understand if whether there is sort of a step back before you can step forward as you get the supply chain straightened out? Thank you.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Bryan, on the first part of that question, Denise mentioned two factors that will impact at least our first half performance in 2017. One is the supply constraints on protein drinks given the production -- the run times, 24 hours versus 72. And the other thing is given some loss of customers on carrots, it will take us a little bit of time to re-acquire that business.

And so, as we look at C-Fresh for the full year we expect top-line growth low-single-digits. Typically we would look for high-single-digits so obviously that is impacting our 2017 outlook. And as far as innovation, I don't think the issue on this particular line has an impact on our innovation agenda.

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

It does not. I would say though in the first half the team will be very focused on the fundamentals. So the new product innovations will most likely go to market in the second half.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay, thank you.

Operator

David Driscoll, Citi.

David Driscoll - *Citi Research - Analyst*

Wanted to ask a little bit about the cost savings and the re-investment strategy. So kind up back at the beginning I think, Denise, the plan was to take about half of the big cost savings that were coming in and reinvest it back in the business. But then you had this kind of what wonderful event of the cost savings tumbled in faster, larger -- all these good things that happened in the year.

But it brought up the question as to when would all this reinvestment occur. So, if we are still looking for something like $150 million of reinvestment, will most of that occur in fiscal 2017 or can you give us some guidance on how the reinvestment plan lays out?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Yes, I think I'll try that. So, when we first announced the cost savings program we were targeting $200 million of savings and we talked about half of that going back for re-investment. I think as the savings level went up I think we kind of held the re-investment amount, so I don't think we are would estimate that -- I think I would estimate that less than half is now going back in the business.

We are not going to give a specific dollar amount in terms of reinvestment in 2017, but it is significant and it is in a number of areas. We are going to support new product launches, things like Prego's Farmers' Market, Well Yes! soup, Plum infant formula, the Bolthouse spring innovation, Tim Tam's expansion in the US, Goldfish made with organic wheat -- so we have a number of product launches going on.

We are also going to invest in new capabilities around things like digital and e-commerce. We are going to make investments in our Real Food initiative, so these are things like improving our can liners, continuing the removal of BPA, improving the product and more clean label, those types of ingredients which tend to be a little more expensive.

We are going to invest in longer-term innovation, things like our Acre investment fund. And also Denise mentioned long-term innovation in Packaged Fresh. We are also going to invest and add resources to expand our sales and distribution in China through our Kelsen business. So we have quite a list of areas we are looking to re-invest and the P&L we have a significant allocation of funds.

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

Yes, and, David, our profit is strong, our challenge is top-line growth. So these investments are really vital to the long-term health of the sales line of the Company.

David Driscoll - *Citi Research - Analyst*

So, it sounds like it is fair to say that a big portion of the investment is happening now but will also happen in F18 and beyond. I think that is what you are trying to tell me. Is that right, guys?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Well, it is certainly F17; I am not commenting on F18 at this point, but --.

David Driscoll - *Citi Research - Analyst*

All right, one clarification -- and apologies for this but I have got to ask this. The pacing of the quarterly earnings -- so there was amazing growth in Q1 and Q2. You didn't really say this into prepared comments, Anthony, but will you actually be at or above the year ago 1Q and 2Q numbers? I mean is there any chance that these are below those year ago numbers just because of how tremendous Q1 and Q2 were last year?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

We did say the majority of growth will come in the second half. And as you point out, there is two reasons for that. We are lapping a relatively low marketing Q1-Q2 and we have these lingering issues on C-Fresh. So that will tend to suppress our first-half performance, but we will see it come back in the second half.

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

Yes, we have a much stronger marketing investment in the first half, particularly in the Americas Simple Meals and Beverage with four really big campaigns.

David Driscoll - *Citi Research - Analyst*

Thank you so much. I will pass it along.

Operator

Jason English, Goldman Sachs.

Jason English - *Goldman Sachs - Analyst*

I've got two quick questions. First, I am not really sure what you meant when you answered Dave Driscoll's question in terms of cadence. So I will ask it a little more directly. Do you expect earnings to be down year-on-year in the first half of the year?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

We are not going to give specific guidance, but I would say we expect relatively weaker performance in the first half and stronger performance in the second half.

Jason English - *Goldman Sachs - Analyst*

Okay, I had to try. My second question relates to promotional spend. Early last year as you kind of went into the year you talked about some opportunities to rationalize the spend. There were glimmers of hope through the first of the year as that promotional line in the Americas Simple Meals, Beverage [they actually went positive]. We've given that back in the back half of the year.

So, can you kind of update us on how you are thinking about your promotional posture, your promotional spend and what caused the setback as you progressed through the year?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

I guess we look at it a little bit different than that. We are very focused on improving our gross margin performance and expanding margin. Within that we look to net price realization, productivity improvements to exceed inflation.

On the net price realization we feel really good about what we have been able to accomplish in 2016. In fact, 40 basis points of our 170 basis point gross margin improvement is driven by net price realization.

And within that -- and it gets a little distorted on the sales variance -- but we made meaningful reductions in trade spend in soup given the promotional pricing we have taken on RTS. And although it has impacted volumes it has contributed significantly to margin expansion.

Now we were up a little bit in the fourth quarter, it is a non-seasonal quarter for us. Most of our dollar increase in trade in the fourth quarter relates to our Arnott's business in Australia -- we are lapping a period of supply constraint, so we had to pull back on our promotional activity so we are wrapping that.

But as I look at the whole year, we accomplished what we set out to do in our plan and have made meaningful progress, especially in soup, which is a very critical to our agenda going forward.

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

Let me build on that, that we also, as part of the setup of our integrated global services, have made investments in our revenue management and advanced analytics. And we are continuing to look for ways to manage the depth and frequency of our trade programs to maximize profitable volume. We have to take into consideration competitive activity and customer programs and consumer response, but this is definitely a point of focus for us.

Jason English - *Goldman Sachs - Analyst*

Very good. Thank you so much for the time. I will pass it on.

Operator

Robert Moskow, Credit Suisse.

Robert Connor - *Credit Suisse - Analyst*

Hi, this is actually Robert Connor on for Rob Moskow. So we just had a question -- so it looks like some of these smaller organic brands are more vulnerable to weather disruptions and kind of like the stability of the product on the shelf is shorter. It seemed like WhiteWave with their Earthbound Farms brand, they had supply chain issues and obviously you guys are having issues kind of with the Bolthouse brand supply chain.

So, does it raise any concerns in your mind about kind of putting most of your growth in the fresh part, which has kind of more volatile supply chain and lower margins?

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

It all starts with the consumer and the consumer trends are very strong in terms of health and well-being and particularly in fresh food. Some of these issues are part and parcel to running a fresh food business. But in our case these were execution issues and we can do better there. So, we are really confident in the strategy to pursue fresh food in addition to the strong core brands that we have.

Robert Connor - *Credit Suisse - Analyst*

Great, thank you.

Operator

Matthew Grainger, Morgan Stanley.

Matthew Grainger - *Morgan Stanley - Analyst*

Anthony, I just wanted to ask a little bit more about the inflation outlook. And apologies if I missed this earlier, but did you mention what inflation was here in the fourth quarter? The was margin headwind seemed to step up quite a bit versus what we had seen year to date. So I am not sure how material the other portion of that was related to Bolthouse issues. And if you could give us any color on kind of the shape of the inflation curve as we kind of move forward sequentially.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Sure. I think the best way to explain our gross margin performance, which was down 90 basis points in the fourth quarter, is just to parse out the impact of the C-Fresh division.

So, the C-Fresh division in aggregate had a 70 basis point impact out of the 90 basis points. So basically most of our gross margin decline is attributable to the two issues inside of C-Fresh, the recall which was 50 basis points, and the decline on carrots which has an impact on the margin as well.

And looking at the rest of it, inflation was not that great in the fourth quarter as we talked -- in the bridge the higher promotional expense was the key swing relative to prior quarters. But most of the decline, as we said, attributable to the C-Fresh performance.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay, that helps. Thanks. And just one other quick clarification from a guidance standpoint. Incentive, obviously you delivered 11% underlying EPS growth this year, but there was I guess perhaps an accrual correction on incentive comp here in the fourth quarter which resulted in a year-on-year decline in there. As we kind of think ahead to 2017, does incentive comp end up being a headwind or a tailwind or are you kind of essentially at a normal run rate at this point?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Yes, so we had some ups and downs obviously in 2016. We ended up with a $0.02 headwind in 2016 versus 2015. And looking forward our short-term incentives are close to target, the long-term incentive will go up a little bit. All in we had about a $0.02 negative impact in 2017.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay, great. Thanks, Anthony.

Operator

John Baumgartner, Wells Fargo.

John Baumgartner - *Wells Fargo Securities - Analyst*

Denise, I would like to ask about M&A. In addition to the chassis you feel that you have with the carrot business, it also seemed that you have a fairly nice chassis with your distribution model at Pepperidge. So, how do you assess the ability for M&A to maybe accelerate growth more broadly in US snacking maybe even outside of C-Fresh? And how much more could you be doing at Pepperidge to leverage your route to market there?

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

Yes. Yes, I wanted to clarify that. We look at -- we do look at M&A more broadly than just Campbell Fresh. And each one of our divisions has mapped out specific targets that they are interested in that are a good strategic fit for their businesses. And so we are highly interested in other consumer behaviors like health and well-being, like snacking, like simple meals that we can pursue not only from an organic growth standpoint but also from an M&A standpoint.

John Baumgartner - *Wells Fargo Securities - Analyst*

And you feel that your route to market with the DSD at Pepperidge allows you to kind of go into that and accelerate growth with kind of a bolt on?

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

I am sorry, I didn't understand the question.

John Baumgartner - *Wells Fargo Securities - Analyst*

You feel as though your route to market at Pepperidge through kind of DSD network would allow you to kind of buy a smaller artisanal brand, [just like] more in the health and wellness base and really kind of accelerate?

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

Absolutely. I mean Plum Organics is a great example of a smaller brand that we bought. We were able to integrate that into the Americas Simple Meals and Beverage business and capitalize on things like their sales force and supply chain.

John Baumgartner - *Wells Fargo Securities - Analyst*

Thank you.

Operator

David Palmer, RBC Capital Markets.

David Palmer - *RBC Capital Markets - Analyst*

A question on a couple areas that I know that you would like to improve and that was ready-to-serve soup and Chunky in particular and then also V8. Your new marketing campaign for Chunky, it looked promising and your comparisons will be on your side.

Realistically speaking, do you think that that is the business that has the best chance for improvement among the areas that you cited that you think will improve in fiscal 2017? And then perhaps you can dimensionalize what you think would be a successful step in the right direction. Could you get back to flat for that business in ready-to-serve for instance?

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

Yes. We definitely have some bright spots in soups this year. We basically stabilized condensed and broth is up for the year. But the issue we have had has been RTS soup. And as you indicate, with brand Chunky we have the price realization behind us, we have improved Chunky marketing going into 2017, we had a label execution issue in the first and second quarter last year that we are cycling. And then we can't control the weather, but that was definitely an impact in 2016.

So we believe that the Chunky brand will have improved performance in 2017. In addition, we are launching Well Yes! midyear, which is a great tasting clean label ready-to-serve soup that we believe will have disruption in the soup aisle and capture the hearts and minds of consumers.

The other thing we have going for us in soup is Slow Kettle and organic soups continue to do very well. And we just came out with new stackable cans in our RTS soup, which has been received really, really well from the retailers for merchandising purposes. So, we have got a lot more going for us this year than last year and we expect soup to grow modestly.

David Palmer - *RBC Capital Markets - Analyst*

Great, thank you.

Operator

Mario Contreras, Deutsche Bank.

Mario Contreras - *Deutsche Bank - Analyst*

So, actually just following up on the previous question. I think there was also a question on V-8, so I just wanted to add onto that. So, that has been an area of investment. You mentioned some further investment in terms of marketing and advertising, but sales continue to be a headwind there. So could you just talk about the results that you are seeing from some of those investments? Are we at an inflection point where that is starting to improve? Thanks.

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

Yes, thanks for that reminder. We continue to be challenged in our shelf stable beverages, particularly on our products that contain sugar. So V8 V-Fusion, for example. And this year we actually did have some declines on our V8 Red. Our new Veggie Blends, which we supported with some good marketing support, continue to grow and our V8 +Energy is growing really nicely.

What we have done is we have developed a brand-new campaign, but also we have increased our support around our V8 Red juice. So instead of just promoting the new parts of the business we are going back to better balancing of our marketing against the core V8 Red as well as the new Veggie Blends and the V8 +Energy. And we believe that that is a much better formula for success. We don't expect beverages to grow next year but we do expect improved performance.

Mario Contreras - *Deutsche Bank - Analyst*

Okay, and just a clarification. I think going back to your Analyst Day, you mentioned something about shifting some consumers from V-Fusion to Veggie Blends. Should we read into that that you are looking for V-Fusion to eventually maybe not be eliminated but just become much less significant? Or I guess what did you mean by that specifically? Thanks.

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

We have -- we do have top-selling varieties in the V-Fusion line such as strawberry banana or pomegranate blueberry and some others and we will continue to include them in the V8 line. But the consumer will take us to the flavors that they like and we'll repeat. So that is basically how we are playing it.

Mario Contreras - *Deutsche Bank - Analyst*

Okay, thank you very much.

Operator

And that concludes the Q&A session. I will now turn the call back over to management for further remarks.

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

Thanks, Stephanie. Thanks, everyone, for joining our fourth-quarter earnings call and webcast. 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 167-3833. You have until September 15, 2016 at midnight at which point we move our earnings call strictly to the website. Just click on recent Webcasts & Presentations.

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

Operator

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