

09-Mar-2022

Campbell Soup Co. (CPB)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

Rebecca Gardy

Vice President-Investor Relations, Campbell Soup Co.

Mick J. Beekhuizen

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

Mark A. Clouse

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

OTHER PARTICIPANTS

Andrew Lazar

Analyst, Barclays Capital, Inc.

Filippo Falorni

Analyst, RBC Capital Markets LLC

Ken Goldman

Analyst, JPMorgan Securities LLC

Peter T. Galbo

Analyst, BofA Securities, Inc.

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

David Palmer

Analyst, Evercore ISI

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is April, and I will be your conference operator today. At this time, I would like to welcome everyone to the Campbell Soup Second Quarter Fiscal 2022 Earnings Conference Call. Today's call is being recorded. All participants will be in a listen-only mode until the formal question-and-answer portion of the call. Thank you.

With that, I would like to hand the conference over to your host, Ms. Rebecca Gardy. Ms. Gardy, you may begin your conference.

Rebecca Gardy

Vice President-Investor Relations, Campbell Soup Co.

Good morning and welcome to Campbell's second quarter fiscal 2022 earnings conference call. I am Rebecca Gardy, Head of Investor Relations at Campbell Soup Company. 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 pre-recorded. Once we conclude the 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 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 3 of our presentation 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 overall thoughts on our second 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'm pleased to turn the call over to Mark.

Mark A. Clouse

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

Thanks, Rebecca. Good morning and welcome to our second quarter earnings call for fiscal year 2022. Before I turn to the results of the quarter, I want to take a moment to thank all our teams, especially our frontline colleagues for navigating the impact on our operations during another difficult period of the pandemic. We are now at the two-year mark of working within this challenging COVID-19 environment. And I'm very proud of their perseverance, continued performance and dedication. I also want to take a moment to express our concern for the people of Ukraine. Our sympathies and support go out to them during this crisis.

As we outlined during the Q1 earnings call and as you saw in our press release, Q2 was challenging, as we expected, including industry-wide constraints on labor and materials availability made even tougher by the winter Omicron surge, as well as ongoing commodity and logistics inflation.

However, more recently, labor and service levels are improving as COVID cases decline and we see greater impact from our aggressive hiring and training. Since October, our full-time filled head count increased by 10 points, and we now see absenteeism and vacancy rates trending back to normal levels. This is translating to more production and the beginning of a return to normal distribution and inventory levels.

We do continue to expect inflation to remain persistent, especially as it relates to logistics. And although we have no direct exposure to Ukraine and Russia, we are monitoring any broader economic impact from the current crisis, especially on commodities.

As we look forward and including the balance of these factors, combined with the greater impact from pricing actions, easing prior year comparisons and continued strong demand across our portfolio, we remain confident in reiterating our previously communicated full year fiscal 2022 guidance. We look forward to returning the business to growth, while building momentum in the back half and exiting the year a more capable and stronger business.

Now, let's cover some specifics from Q2. Organic net sales were down 2%, primarily driven by industry-wide labor and supply challenges more than offsetting the favorable impact of net pricing in the quarter. On a two-year basis, organic net sales remained elevated, growing 3%.

In-market performance remained positive, up 1%. This was 3 points ahead of net sales in the quarter, reflecting a lag in inventory replenishment and lower distribution levels due to previously mentioned supply constraints. The in-market demand was balanced across both divisions. On a two-year basis, consumption grew 9%. And importantly, our brands in 12 of our 13 core categories continued to grow in-market consumption.

Despite this growth, as expected, we experienced short-term market pressure on certain brands. These share losses tend to line up very closely with where our distribution levels are down. Supporting supply is the key driver

of this pressure. As we recover distribution and can fully support our portfolio, we expect to return to share recovery as we move through the second half of the fiscal year.

Turning to profit, lower volume and accelerating inflation weighed on margins and earnings, resulting in a 17% decline in adjusted EBIT and a 16% decline in adjusted EPS in the quarter, both very much in line with our expectations.

Turning to our Meals & Beverages division, I continue to be pleased by the underlying health and strength of demand for our portfolio. Consumption grew 1% over prior year and was up 11% versus two years ago despite our supply challenges. Organic net sales decreased 2% versus prior year, lapping 5% growth in the prior year.

Turning to soup on slide 9, the next chapter of our Win in Soup strategy continues to deliver growth. In-market soup consumption continued to be ahead of the elevated levels in the prior year, increasing 3% versus prior year and 10% compared to two years ago.

In the quarter, we continued to see strong share performance on key brands, but as expected, we did see pockets of share declines. In particular, on condensed soup, we continue to remain very confident in our overall competitive position. However, we experienced some share pressure as private label lapped an extended period of supply constraints.

As you see on slide 10, we had continued success with younger buyers. We performed very well and brought in additional millennial and Gen Z buyers to both our condensed eating and cooking varieties in the second quarter.

On total US soup, household penetration in the quarter was up versus both the prior year and two years ago. And importantly, we continue to see more consumers participating in the soup category and purchasing our soup brands compared to pre-pandemic levels. While dollars spent per buyer increased due to our pricing actions, volume per buyer remained relatively stable to pre-pandemic levels despite specific supply constraints in the quarter.

For the important holiday period, our soup and broth posted its second largest holiday in the last five years, only down compared to last year as consumers returned to fewer, larger gatherings during this holiday season.

In ready-to-serve, Chunky had a very strong quarter, increasing consumption 9% on top of the 13% growth in the prior year quarter, leading to an astounding 25% consumption growth and over 2 points of share growth on a two-year basis. As we shared at Investor Day, lunch is a key occasion for this brand, and people are now eating even more low prep lunches compared to prior year. Our focus on the lunch occasion highlighted through a successful advertising campaign, Lunchtime Is Your Halftime with Super Bowl winning coach from the Rams, Sean McVay, is driving a positive sales lift, including among younger households.

Also, our latest innovation, Chunky Spicy, which we are expanding, is adding to the strong results of this important brand. In fact, Chunky Spicy Chicken Noodle launched earlier this year is already in the second quartile of all ready-to-serve items with strong trial and repeat.

Turning to Swanson broth and stock, the continued supply recovery led to a fourth consecutive quarter of share growth, up 1.2 points in the quarter, a clear win during the important holiday season and a good example of where supply recovery directly translated to share recovery.

On sauces, Prego continues to be the number one share leader. However, some supply challenges on our Prego Alfredo sauce put pressure on share. We expect a steady recovery of supply beginning in the fourth quarter. Pace share continues to improve, while V8 beverage experienced some share loss in the quarter due to high-single digit declines in total points of distribution, or TDPs, compared to prior year driven by material shortages, especially aluminum cans.

Turning to our Snacks division on slide 12, organic net sales were down 3% versus prior year, but compared to two years ago, grew 3%. On Snacks, we expected a significant impact from supply constraints we experienced. Despite these constraints, in-market consumption grew 1% over the prior year quarter and 8% on a two-year basis, reflecting the underlying strength of our brands, especially our power brands.

In fact, our Snacks power brands continue to fuel performance with in-market consumption growth of 3% versus the prior year and 9% compared to two years ago, reflecting our efforts to prioritize power brands and to remain competitive. We are encouraged to see repeat rates ahead of prior year on seven of eight power brands and ahead on a two-year basis on all power brands. Particular standouts were our Kettle Brand potato chips and Cape Cod potato chips, where we have successfully added capacity. Each had a strong quarter with consumption growth of 26% and 20% compared to two years ago, and share growth of almost 2 share points combined.

Turning to Goldfish, also an area of significant capacity expansion and supply recovery, we performed well in the quarter, holding share in a competitive marketplace and growing consumption by 9%. As we outlined at Investor Day, we recently launched our Goldfish Mega Bites, a bigger, bolder, cheesier Goldfish cracker, and our Family Size Goldfish aimed at meeting key consumer trends. Both are off to strong starts. We are executing our plan to elevate innovation based on consumer insights, resulting in bigger, more impactful ideas.

Since the launch in January, Mega Bites achieved the fastest distribution growth in recent history of Goldfish innovation launches. Early consumer repeat rates are promising as consumers who purchased once are already coming back to buy again. We launched in January with a highly impactful PR and social campaign. And within its first week alone, Mega Bites achieved over 1 billion earned media impressions. The full activation will run through the summer, and I have to say it feels good to return to what we do best, building our brands.

This is an important proof point as we pivot from supply recovery to now running the business in what we believe will be more predictable conditions as we come through the rest of the fiscal year and into fiscal 2023.

Lastly on Goldfish, continuing our successful limited time offer strategy, we're excited about the launch of the limited edition Star Wars The Mandalorian Cheddar Crackers. We have another limited time offer Goldfish release planned for the early summer, including another surprising one-of-a-kind flavor collaboration.

As we mentioned last quarter, we expected short-term share headwinds due to supply constraints on certain snack brands, specifically, in Late July snacks, Snyder's of Hanover pretzels and Lance sandwich crackers. Similar to supply pressures on Meals & Beverages, share pressure aligned with lower TDPs in the quarter compared to prior year. We have taken actions to improve overall performance, including core SKU prioritization efforts to increase production while reducing complexity, as well as prioritizing plant labor recruiting, training and retention.

We feel confident these share headwinds are temporary as we've already seen strong improvement in our labor and production levels. As a result, we will return to our planned levels of investment through the back half of the fiscal year and expect to be fully back on track for what our snack brands do best, growing consumption and share.

To conclude, we expected Q2 to be tough as we navigated challenges and lapped strong performance from a year ago, and it was. We also expect stronger year-over-year performance in the second half of the fiscal year as we lap easier prior year comparables. In addition, we are in an improving position to meet our strong brand demand throughout the balance of the year as our staffing levels and vacancy rates are improving, with nearly 3,500 new hires in the last seven months.

Also, in the second half, through the combination of our most recent pricing actions, our continued supply chain productivity improvements and cost savings initiatives, we will be better positioned to help offset ongoing inflationary pressure. We will remain nimble and use our full range of tools to offset additional inflation as needed, including potential further pricing actions where appropriate. Accordingly, we expect meaningful improvement and recovery in margins, profit and EPS in the balance of the year. And we remain confident in our plans and full year outlook.

Before I turn it over to Mick, I'd like to share a change to my leadership team. First, I'd like to take a moment to thank Bob Furbee, our Executive Vice President, Global Supply Chain Officer, who will be retiring after nearly 40 years with Campbell. Bob has had a remarkable career at Campbell and has been a key part of our transformation. We are deeply grateful for his contributions and wish him the best in his retirement.

As we announced in January, our incoming Executive Vice President, Chief Supply Chain Officer, Dan Poland, is working to drive operational excellence across our network. He brings extensive experience at all levels of the CPG supply chain, and has a track record of building high-performing teams, delivering exceptional product quality and driving execution, which will be invaluable as we continue to deliver growth, while also navigating one of the most dynamic and challenging supply chain environments.

With that, I'll turn it over to Mick.

Mick J. Beekhuizen

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

Thanks, Mark, and good morning, everyone. Our second quarter fiscal 2022 results are generally consistent with our expectations, despite industry-wide inflation and supply constraints. As you heard Mark describe earlier, strong demand for our portfolio of brands continued in the second quarter. However, higher-than-expected supply chain volatility resulted in lower service levels. Additionally, as expected, accelerating core inflation in the quarter pressured margins. We continue to feel good about our initiatives to mitigate inflation, which include price increases, trade optimization, supply chain productivity improvements and cost savings initiatives.

Our cash generation remains strong, with cash flow from operations of \$766 million through the first half. Additionally, in line with our commitment to return value to shareholders, year-to-date, we have returned nearly \$300 million to shareholders through dividends and share repurchases.

Our first half performance and improving second half outlook, including inflation mitigation actions and continued strong consumer demand despite a tight, but improving labor market, give us confidence in reaffirming our full year guidance.

Turning to slide 19, organic net sales declined 2% in the quarter, lapping 5% growth in the prior year. The year-over-year volume decline due to industry-wide labor and supply challenges more than offset the favorable impact of net pricing in the quarter. Consumer demand remains strong, with second quarter dollar consumption, in

measured channels, 3 points above our total organic net sales performance. Relative to the second quarter of 2020, organic net sales grew 3%.

Adjusted EBIT decreased 17% compared to the prior year quarter and was 12% lower on a two-year basis due to significant levels of inflation on ingredients and packaging, transportation, and labor. Remember that, our Wave two pricing will not be fully reflected until the third quarter. Adjusted EBIT margin declined by 240 basis points to 14.4%, compared to 16.8% in the prior year.

Adjusted EPS from continuing operations decreased \$0.13 or 16% versus prior year quarter, and was 4% lower on a two-year basis to \$0.69 per share.

Year-to-date, organic net sales declined 3% lapping 7% growth in the prior year period, resulting in 4% growth on a two-year basis. Adjusted EBIT decreased 16% compared to prior year, and was down 6% on a two-year basis, given significant inflation. Year-to-date, adjusted EPS decreased 13%, but grew 6% on the two-year basis as a result of deleveraging.

On the next slide, I'll break down our net sales performance for the second quarter. As I mentioned, the industry-wide labor and supply challenges held back our ability to meet the continued strong demand. Organic net sales decreased 2% during the quarter, driven by an 8-point volume and mix headwind, which reflects the supply constraints. Favorable price and sales allowances drove a 5-point gain in the quarter and lower promotional spending in the quarter drove a 1-point gain. The impact of the sale of Plum subtracted 1 point. All-in, our reported net sales declined 3% from the prior year.

Turning to slide 22, our second quarter adjusted gross margin decreased by 340 basis points from 33.8% last year to 30.4% this year. Volume/mix had a negative impact of approximately 170 basis points on gross margin, largely due to reduced operating leverage. Net price realization drove a 480 basis point improvement due to the benefits of our pricing actions, as well as lower promotional spending due to supply constraints.

Inflation and other factors had a negative impact of 820 basis points, with nearly three quarters of the decline driven by core inflation, as overall input costs on a rate basis increased by approximately 9%. Along with other industry participants, we experienced significant inflation across all input cost categories, including ingredients and packaging, transportation and labor.

The remaining decline was driven by increases in other operational costs, due in part to supply chain disruptions. That said, our ongoing supply chain productivity program contributed 140 basis points to gross margin, partially offsetting these inflationary headwinds. Our cost savings program, which is incremental to our ongoing supply chain productivity program, added 30 basis points to our gross margin.

The previously described initiatives to mitigate inflation, highlighted on the next page, include 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 inflation mitigation, as we now expect core inflation for the year to be low-double digit, up from previously expected high-single digits, with a more pronounced impact in the second half of fiscal 2022.

Wave two pricing was effective at the end of the second quarter and will be fully reflected in the third quarter. And although for the second half of the fiscal year, we have a large proportion of our raw materials covered, from a

pricing perspective, as Mark previously mentioned, we continue to closely monitor any economic impact from the current crisis in Ukraine.

Moving to the next slide, we have continued to successfully deliver against our multi-year enterprise cost savings initiatives. This quarter, we achieved \$15 million in incremental year-over-year savings, bringing program-to-date savings to \$835 million, and we remain on track to deliver total savings of \$1 billion by the end of fiscal 2025, as we shared during our Investor Day.

Moving on to other operating items, marketing and selling expenses decreased \$35 million or 15% in the quarter on a year-over-year basis. This decrease was largely driven by lower advertising and consumer promotion expense, or A&C. Although A&C declined 27% as investment was moderated to reflect supply pressure, we expect it to normalize as supply strengthened throughout the year. Overall, our marketing and selling expenses represented 8.9% of net sales during the quarter, a 130 basis point decrease compared to last year.

Adjusted administrative expenses decreased \$8 million or 5% due to benefits from cost savings initiatives and lower benefits-related costs. Adjusted administrative expenses represented 6.5% of net sales during the quarter, a 20 basis point decrease compared to last year.

On slide 26, we are providing a total company adjusted EBIT bridge to summarize the key drivers of performance this quarter. As previously mentioned, adjusted EBIT declined 17% as the sales volume decline and the 340 basis point adjusted gross margin contraction resulted in a \$70 million and \$29 million EBIT headwind, respectively. Partially offsetting this was lower marketing and selling expenses, contributing 130 basis points to our adjusted EBIT margin.

Lower adjusted administrative and higher R&D expenses had a neutral impact and lower adjusted other income had a 30 basis point negative impact. Overall, our adjusted EBIT margin decreased year-over-year by 240 basis points to 14.4%.

The following chart breaks down our adjusted EPS change between our operating performance and below the line items. A \$0.16 impact of lower adjusted EBIT was partially offset by a \$0.02 favorable impact from lower 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 \$0.69, which was down \$0.13 per share or 16% compared to the prior year.

Turning to the segments, in Meals & Beverages, organic net sales which exclude the impact from the sale of Plum baby food and snacks business declined 2%, driven by declines in US retail, including US soup and Campbell's pasta, as well as in Canada, largely offset by gains in foodservice.

Volume declined due to supply constraints driven by labor and materials availability. Price and sales allowances were favorable in the quarter, partially offset by increased promotional spending relative to moderated levels in the prior year quarter. Sales of US soup decreased 1%, cycling a 10% increase in the prior year quarter due to declines in condensed soup, partially offset by gains in ready-to-serve soups and broth.

Segment operating earnings in the quarter decreased 19%. The decrease was primarily due to sales volume declines and lower gross margin performance, partially offset by lower marketing and selling expenses.

Gross margin performance was impacted by higher cost inflation and other supply chain costs, unfavorable volume/mix, which was largely due to reduced operating leverage, as well as higher levels of promotional

spending, partially offset by the benefits of pricing actions and supply chain productivity improvement. Overall, within our Meals & Beverages division, the second quarter operating margin decreased year-over-year by 320 basis points to 16.7%.

Within Snacks, organic net sales decreased 3%, while sales of power brands were up 1%. Segment sales decreased due to declines in non-core businesses and in certain salty snacks, primarily Late July snacks, partially offset by gains in Goldfish crackers. Overall, favorable price and sales allowances and lower promotional spending were more than offset by volume declines, driven by significant supply constraints due to labor.

Segment operating earnings in the quarter decreased 14% driven by sales volume declines and increased administrative expenses, partially offset by lower marketing and selling expenses. Increased pricing and lower promotional activity, combined with the results of our productivity and cost savings initiatives, largely offset core inflation, higher other supply chain costs and unfavorable volume/mix, which was largely due to reduced operating leverage. Overall, within our Snacks division, second quarter operating margin decreased year-over-year by 160 basis points to 13%.

I'll now turn to our cash flow and liquidity. Fiscal 2022 cash flow from operations increased from \$611 million in the prior year to \$766 million, 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 \$129 million, which was comparable to prior year. Given the challenging operating environment, we are now forecasting full year capital expenditures of approximately \$275 million for fiscal 2022.

Our year-to-date cash outflows for financing activities were \$352 million, the vast majority of which, or \$293 million, represented the return of capital to our shareholders, including \$228 million of dividends and \$65 million of share repurchases. At the end of the second quarter, we had approximately \$475 million remaining under the current \$500 million strategic share repurchase program. We also have a \$250 million anti-dilutive share repurchase program, of which approximately \$174 million was remaining. We ended the second quarter with cash and cash equivalents of \$357 million.

Turning to slide 31, we continue to expect full year fiscal 2022 net sales, adjusted EBIT and adjusted EPS performance to be consistent with the guidance we provided during our first quarter earnings call. Our full year guidance reflects expected continued strong demand for the balance of the year with steady supply recovery and improved service levels, particularly in the fourth quarter as labor recovers. We have seen consistent improvements in labor attraction and retention driven through the recent recruiting actions and wage increases. However, core inflation is now expected to be low-double digits for the full year.

Wave two pricing will be fully reflected in the third quarter, and we expect to continue managing inflationary headwinds through pricing, supply chain productivity improvements, and cost savings initiatives. We expect these actions and improved labor outlook and easier prior year comparisons to result in margin progress and earnings recovery in the second half.

For the full year, we expect organic net sales to be minus 1% to plus 1%, 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 an impact of 1 percentage point on fiscal 2022 net sales. This implies, for the second half, net sales growth of low- to mid-single digits and double-digit growth in adjusted EBIT and adjusted EPS.

Overall, our first half was generally aligned with our expectations, thanks to all the hard work by our teams. I'm truly grateful for their continued dedication and commitment.

I will now turn it back to Mark for closing comments. Thank you.

Mark A. Clouse

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

Thanks, Mick. To conclude, although we fully recognize the volatile nature of the environment we remain in, we continue to deploy more of our time and resources to future plans, growth and supporting the full potential of our business.

As we outlined at our recent Investor Day, we believe we have an advantaged portfolio in position going forward, and we are excited that in the second half of this fiscal year, we'll begin to transition from defense to offense after this unprecedented period. And I could not be more confident in our team, brands and Campbell's value creation potential.

With that, I'll turn it over to the operator to take your questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question is from Andrew Lazar with Barclays.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Great. Good morning. Thanks very much for the question.

Q

Mark A. Clouse

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

Hey, Andrew.

A

Andrew Lazar

Analyst, Barclays Capital, Inc.

Hey, there. I guess I'd start with, Mark, with more gross margin pressure in fiscal 2Q, a now higher forecast for low-double digit inflation for the full year, it would seem that Campbell's leaning on greater SG&A leverage to sort of deliver the year. So would you say this is a fair characterization? And if so, how do you balance lower A&C spend, right, in light of the supply constraints you've talked about to sort of hit guidance with the opportunity maybe to lean in even harder or spend more on consumer outreach to retain as many new households as you can heading into really it's about fiscal 2023 and 2024, and as you said, kind of playing offense, if you will? Thanks so much.

Q

Mark A. Clouse

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

Yeah. Yeah. So the short answer is, Andrew, we actually see the back half where the opportunity really resides to be more in the gross margin space and there's a couple of reasons why. First, I'll just say from a Q2 standpoint, although a little more pressure on the top line as we went through Omicron in January and saw labor even tougher than what we had expected, from a margin standpoint and profitability standpoint, we were generally in line with what our expectation was.

A

And so as we look into the back half of the year, certainly, we're not expecting inflation to subside. But what we do believe is that with the combination of the full impact of the second wave of pricing, along with the fact that we're going to be lapping pretty significant declines from a year ago, in fact, they're in the 300 to 400 basis point range as a comparison and then the recovery that we expect on the supply side, which drives a host of efficiencies, as well as our underlying productivity and cost savings initiatives, we feel like we're in a much better position with many of the variables pointed in the right direction, even though you'll still have inflation as a significant variable.

And so underpinning those assumptions is a fairly consistent level of costs as it relates to SG&A in total and our marketing and selling in particular, where we have been a bit below or under a year ago over these last couple of quarters, we expect it to be more in line and more consistent with where ultimately we would want to get.

I still think probably a bit of management of that through the third quarter and into the balance of the year. But generally, as a good rule of thumb, we want to be around 10% of net sales. We've been hovering around closer to 8% to 9%. I think you'll see us closer to 9% to 10% as we go through the back half of the year.

So our ability to invest behind the recovery of supply, given the room that we believe we'll have relative to the pricing as well as the comps gives us a lot of confidence, and the ability to drive a positive back half and stay generally on track with where we expected to be at the turn here and this moment that we expected to be in where we begin to transition from, lapping a lot tougher comparables, a lot higher starting points to a period where we can return to positive momentum, which is really something that we're excited to get to, but also I think a good way to kind of build momentum as we exit the year.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Q

Got it. Thanks so much.

Operator: Your next question is from Ken Goldman with JPMorgan.

Ken Goldman

Analyst, JPMorgan Securities LLC

Q

Hi, good morning.

Mark A. Clouse

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

A

Hey, Ken.

Ken Goldman

Analyst, JPMorgan Securities LLC

Q

Hey. Thank you. I'm curious to what degree your guidance factors the recent rise in costs for things like transportation, fuel and energy. Are these the main drivers behind your decision to raise your expectation for core inflation? I guess, I'm asking, because you said, you're still monitoring the situation in Ukraine. I wasn't sure if that indicated you...

Mark A. Clouse

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

A

Yeah.

Ken Goldman

Analyst, JPMorgan Securities LLC

Q

[indiscernible] (00:36:44) on these items or how to think about that.

Mark A. Clouse

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

A

Yeah. No. So, there's a couple of things in there that are probably good to talk about. First, let me start with kind of the pre-Ukraine Russia challenges. And I think what – as you know, at this point in the year, we're fairly well covered. So we're roughly 95% of our costs, about 90% in particular on commodities. But that still does leave some variability as it relates to logistics and added pressure that we've seen relative to fuel that has been aggravated a bit more as we've gone into this latest conflict and crisis in the Ukraine. So I think that, where we see those variables are generally contemplated in our numbers.

As it relates particularly to Ukraine and Russia, first, is, I'd be remiss not to just say again, our hearts go out to the folks that are dealing with this conflict, it's an unbelievable circumstance to be in. But I think from a business standpoint, what I would just say is that from a direct operation or impact, we have no sales, we have no direct sourcing, we have really no specific business. Of course, the question then becomes the macroeconomic impact of the conflict.

And as we look at 2022, we've got about 90% of our commodities covered, which leaves us about \$150 million in cost that we're still navigating through. And as we look at the variability as it relates to what of that is really residing within things like wheat that could be impacted or certain metals or packaging that could be part of that as you look a little more broadly at costs, and then, of course, on energy and oil, we believe that we've created a space within the plan to contemplate that.

And then, of course, as we talk about going forward into 2023, there's a lot of variables there that will come into play, and we'll talk more about that in the future. But I think we have a – again, in the world that we live in today, I would never presume that we can see every variable possible as that certainly prove in the last couple of years to be tough to do. But I think relative to all the inputs we have today, I think we've got a fairly good contemplation of that. And even where we see some potential variability, we've tried to build that into the contingency planning and/or just within the range that we've got relative to the guidance.

Mick, anything to add to that?

Mick J. Beekhuizen

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

A

No, I think, you got it. I think, as we've mentioned in the past, think about kind of ingredients and pack being, give or take, 50% of our overall cost of goods. So then to Mark's earlier point, kind of take the, call it, 95% of that is currently covered, and then you get close to that \$150 million that Mark mentioned.

And then on the logistics, transportation, it's obviously a combination of both, availability which drives price, as well as the overall fuel market that we're monitoring very closely, and we got some coverage on that as well.

So, generally, of course, with where we're at, we got still half the year to go, but we feel relatively comfortable with where we're at. That being said, the piece that's uncovered, we're obviously monitoring very closely and managing.

Ken Goldman

Analyst, JPMorgan Securities LLC

Q

Thank you for that. Can I ask you a quick follow-up, Mick? Historically, has Campbell generally bought ahead for the items of can, ingredients and packaging throughout the year, at somewhat consistent levels from quarter-to-quarter? Or historically, has it tended to lock in a significant amount at the end of the fiscal year with less purchasing at other times? And, I guess, I'm talking everything other than cans, of course, which I think we have a good sense of.

Mick J. Beekhuizen

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

A

Yeah. We tend to have a pretty steady coverage model. So I think our history on this is to try to generate predictability more than it is to necessarily try to win the commodity guessing market.

And I think that consistency has been fairly in line as you look at our coverage position. Certainly, there is some variability depending to the exact market we're in. But generally speaking, our quarterly coverage for the year, the rolling forward coverage is pretty consistent.

Ken Goldman

Analyst, JPMorgan Securities LLC

Q

Thank you.

Mick J. Beekhuizen

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

A

Yeah.

Operator: Your next question is from Chris Growe with Stifel.

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hi. Good morning.

Mark A. Clouse

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

A

Hi, Chris.

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hi. Just a follow-up on the questions around margin. You have, obviously, accelerating pricing coming through. You have inflation accelerating at the same time. I'm just curious about elasticity like one other element of that equation, and it's hard to assess it at this point. It seems like it's very low overall for the industry, and it has been for many of your products. Do you have that accelerating through the year as you take more pricing? And just – I'd be curious what you're seeing there right now.

Mark A. Clouse

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

A

Yeah. I mean, so a couple of things that we're watching through and then I'll tell you what we've kind of planned for the balance of the year. But as you point out, early on and certainly through the first wave of pricing, we've not seen a lot in the way of elasticity. Although I will say that as we have navigated some of these supply challenges, it's a little bit harder to gauge as we've been essentially shipping to what we've been making regardless. So I do think we want to continue to watch that very closely.

But as we plan the balance of the year, what we've assumed is that elasticities do go up and that there is some incremental impact from what we would have seen in our first wave of pricing – in our second wave of pricing, although historical levels, we think, will still be below, given the breadth of inflation that is being experienced across the industry. So, we're not taking necessarily the full level of elasticity, but we are assuming a step-up from what we've experienced.

And I think, again, as I've said from the get-go on this, our goal here is, obviously, to manage appropriately the costs, but also to make sure that we're keeping price gaps and that as we return to full supply and support that we've got the right balancing act as it relates to shares and protecting our equities and our brands as we realize that we've spent a couple of solid years building that.

The last thing we want to do is undermine that with unreasonable pricing. And so I think everything that we're doing up to this point generally is consistent and aligned with the marketplace, and we would expect that to continue although I do think with a bit more elasticity as the year unfolds. And if we're wrong, and it's better than that, then I think that will just create opportunity for us as we go through the balance of the year. But I think a prudent position and one that generally is informed by just kind of, I'd say, at this point, where we are on absolute pricing, which is not insignificant on some of our categories.

Christopher R. Growe

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. And then just a quick follow-on. You talked about the fourth quarter being a period where you're going to have a better supply situation for the business. Is that a quarter where you likely ship ahead of consumption? And if you – is there a rough approximation of how much inventory you need to build or like to build into the market to try to have better inventory availability in the store?

Mark A. Clouse

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

A

Yeah. Well, I think the good news is I don't think we'll be waiting fully to fourth quarter to see some of that replenishment. As we pointed out, we were a little lighter in Q2 on top line than we expected. I actually think that we'll see some more recovery of that earlier on in the third quarter.

And then really, I do think, though, the fourth quarter is a period where we would expect to be more fully back in business, if you will, on the broader range of the full portfolio. I think you'll see TDP levels coming back in the normal ranges. I think you'll see our support both from a marketing and trade standpoint kind of at a sustainable ongoing level. That's the game plan. And so I think we'll probably be ahead, notwithstanding what exactly demand will look like in Q3. But I think relative to what we expect, probably a bit ahead in Q3 and probably a bit more in Q4.

Christopher R. Growe
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you.

Operator: Your next question is from Nik Modi with RBC Capital Markets.

Filippo Falorni
Analyst, RBC Capital Markets LLC

Q

Hey, good morning, guys.

Mark A. Clouse
President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hey.

Filippo Falorni
Analyst, RBC Capital Markets LLC

Q

This is Filippo Falorni on for Nik. Hey. So, you mentioned strong underlying trends from a consumption base. I just wanted to check on your assumptions for household penetration trends in the balance of the year as the economy reopens and as we are starting to see restaurant reservation and restaurant trends to improve. I guess, what are you assuming for penetration in the second half of the year?

Mark A. Clouse
President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yeah. I think as now kind of navigated this up and down period, where, okay, we're kind of into a new normal and then a surge comes back in January and this kind of up and down. As we project out, I think we've got a fairly good base of time now where we can see periods where there were less constraints and what does that mean relative to periods that are more COVID driven or influenced in.

So I think our assumptions as we think about the back half of the year – and remember, the added factor of our ability to more fully supply, because our issues, if you will, relative to being able to fully meet demand were present in the back half of last year, especially on certain brands like Late July or a few of the other areas where we've struggled a bit more on labor and had real challenges kind of getting to that full capacity that we need.

So the combination of those elements together, along with returning support level, we think we're going to hold very well on demand. And even if there is kind of a return to kind of this more balance between away-from-home and in-home, we think the combination of what we're doing, as well as what we expect that baseline to remain at, which although may come down a bit from what we would have experienced in January, we think not necessarily inconsistent with what we might have seen in the summer of last year and some other periods that looked a little bit more consistent to what we expect the back half to be.

So, I think you're going to have a little bit of normalization there, offset by improved supply and support and that, I think, in general, is what's leading us to see a better overall top line. And remember too, not unlike the margin conversation, the first half of this year, we were still lapping significant elevated levels when we get to the – from COVID – the original kind of COVID period, when you get to the second half of this year, we begin to lap the declines or kind of the reduction that already occurred in the back half of last year. So your comps on both margin and on top line are much better as we're in the back half of the year.

Filippo Falorni

Analyst, RBC Capital Markets LLC

Got it. That makes sense.

Q

Mark A. Clouse

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

Yeah.

A

Filippo Falorni

Analyst, RBC Capital Markets LLC

And then on innovation, you mentioned a strong start to Mega Bites in Goldfish. Just if you can expand on, like, general expectation for innovation this year. And then particularly for Goldfish Mega Bites, are you trying to expand the demographic profile of the brand with the innovation, and what are the early trends from a consumer standpoint?

Q

Mark A. Clouse

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

Yeah. So let me answer the question in a little bit of a different way to start it, and then I'll specifically get into it. I think what's really important and what I would imagine that a lot of investors are going to be interested in seeing is what the recovery model looks like as we come back into full supply. And what I like about our Goldfish and our Kettle and Cape Cod on our Snacks business, as well as our Chunky business on our Meals & Beverages, those are all great examples of where we have invested in capacity. We're back fully into supply, and with that came the full level of support.

A

We protected marketing on those businesses, we added innovation, whether it was Mega Bites on Goldfish or Family Size on Goldfish, which was some of the new price pack architecture that we were creating, whether it was some of the new pack sizes on Kettle and Cape Cod, or it was flavor innovation on Spicy for Chunky with a full very, very robust marketing campaign. All three of those businesses are great examples of what we expect to see as we come back fully on other brands along the way. And I think that with that comes the opportunity to unlock innovation.

And so as we think about the balance of the year, our innovation levels on our snacking business are going to be up significantly from a year ago and where it would have been – we talk about it in terms of kind of three-year rolling contribution as a percent of revenue. So, last year, we would have been in the 1% to 2% range. This year, we'll add about a full point of contribution from innovation in snacking; Meals & Beverages, on a similar level, with the combination of what we're doing on our Chunky business, but also some of the innovation that we have on the restage and relaunch of Well Yes!, which is another component of soup that's going very well.

And I would encourage you to look at – when you look at shares within soup, look at some of those core brands on how well they're doing because I think it is a little bit of us selecting where we're placing the bets right now as we navigate some of these supply challenges.

But at the end of the day, I think the idea is that we should see momentum building on innovation. We've got a great start on the brands that are already back in the profile that we want, and we would expect the others to follow as we go through the balance of this year and then into 2023, of course, where we expect to be back kind of fully loaded across the portfolio.

Filippo Falorni

Analyst, RBC Capital Markets LLC

Got it. Thank you, guys. I'll pass it on.

Q

Operator: Your next question is from Peter Galbo with Bank of America.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Hey, Mark and Mick. Good morning. Thanks for taking the questions.

Q

Mark A. Clouse

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

Hey, Peter.

A

Mick J. Beekhuizen

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

Good morning.

A

Peter T. Galbo

Analyst, BofA Securities, Inc.

Mark, I guess I just want to go back to your comments around the puts and takes on some of the ag commodities beyond where you're hedged for this year. And, I guess, as I read through kind of what you're saying, it's, hey, we're going to get material improvement or improvement in the gross margin line in the back half of this year, but once some of these ag commodities' hedges roll off or coverage rolls off, maybe you could see that step back down in the front half of next year if we – and some of these other, again, ags kind of stay up here. I wanted to see if I was kind of understanding that comment. And then with that, if that is the case, just your potential to take a third wave of pricing and how you're thinking about that. Thanks.

Q

Mark A. Clouse

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

Yeah. No, it's a great question and one that is an area where we're spending a great deal of time right now, which is recognizing kind of covered, uncovered positions as we go into next year. It's a little early to start to talk about 2023 as far as how we see inflation and the puts and takes. Remember, you'll also have full kind of impact of the rollover of the pricing that we're taking now, as well as some of the added benefits, I think, of a supply chain that's operating in a far more consistent and kind of fully loaded way, which will be very beneficial to us.

A

But I think you're right, and I think that indicates also to us that we are absolutely not ruling out any additional pricing that may need to happen. And I think in the spirit of what we've kind of learned to date, we're looking at that right now, and understanding where and what and the surgical nature of how to digest a little bit of what we're seeing right now.

Again, I would just caution there's a lot of volatility in certain commodities as it relates to Ukraine and Russia. I think we need a little bit more stability of time to know what the underlying availability investment pricing looks like. But there's no doubt there's going to be pressure that's associated with that. And so, I absolutely would not rule that out.

I think, again, as you make each step in pricing, I think the need to be even more strategic, more surgical in nature, really tying it directly to where commodity pressure could reside, I think is areas we're going to continue to explore. And that may mean that even in this – or in this fiscal year that we've got to look at more pricing in a way to position kind of the back end of this year as well as into next year.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Great. Thanks very much, Mark. That's really helpful. I'll pass it on.

Mark A. Clouse

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

A

Okay.

Operator: And your next question is from David Palmer with Evercore.

David Palmer

Analyst, Evercore ISI

Q

Thanks. Thanks for your comments earlier on shipments versus consumptions. I wanted to maybe get a sense from you about what's going on behind the scenes there, what's helping going into...

Mark A. Clouse

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

A

Yeah.

David Palmer

Analyst, Evercore ISI

Q

...fiscal 2H. Is it your own staffing levels, it's freight or co-packers? Any detail would be interesting and helpful.

Mark A. Clouse

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

A

Yeah. So the overwhelming dominant improvement is in labor. If you remember, back in the first quarter, we had anticipated a trajectory of recovery that was really through the second quarter into the back half and what occurred in December and January with Omicron just kind of delayed it. I think what's good news about what we've experienced is that, although that kind of came fast and furiously into the quarter, it also subsided a lot faster than we'd seen prior iterations of pressure. And so it allowed us to get back on track.

And as I said a couple of times throughout the quarter, the fact that we had hired as many new folks as we had allowed us, I think, to weather the storm a little bit better and get us in a position in the back half. But just to put it in context, we were running – if you combine absenteeism and vacancy rates, we were running low-double digit percent of gap relative to that. And if you look at where we are now, historically, we tend to be around 3% to 4%, and we're at about 4% right now. And so that has been the single biggest movement, if you will, in improving our production levels relative to meeting demand and meeting expectations. So that's first and foremost.

I think the other thing is that, we are really working hard on continuing to add capacity. One of the things that's really interesting is if you look at the last 24 months, and I would say this has been a little slower than I would have liked. But if you look at the last 24 months, we've added almost 8% of capacity to our network. And in

particular, you see that manifesting on brands like Goldfish, like our Kettle potato chip business, where you're seeing the benefit of that added capacity.

So those two areas, right, and we have that coming as it relates to tortilla chips, as it relates to cookies. These are areas that we're also experiencing – sandwich crackers on Lance, which has another – been a challenging area. So I think the combination of those two things together are what's really giving us the better confidence.

And again, throughout this process, our overall execution has actually been very good relative to what we might have experienced a year ago or in prior levels. And I only expect that to get better as we continue to focus on that as a really core capability. We continue to add resources. This is a specific area of expertise for Dan Poland, who I mentioned earlier is joining the company, very, very good at driving standardization and operational excellence across the network.

In particular, in our Snyder's-Lance facilities, that is a network that really we see the biggest opportunity in elevating that level of consistency and performance. And so, with that set of tools, along with kind of the structural improvement of labor and capacity, it's why we feel as good as we do about that recovery.

So, hopefully, that helps give you a little bit of color, but it's a great question and one that we think is really paramount to the believability of the second half recovery and why we see it as a more likely outcome than it might look like on paper.

David Palmer

Analyst, Evercore ISI

Q

That is helpful. And just a small follow-up on that is, if you – retailer inventory, where would you say that is versus history, and I think you are alluding to maybe being – having shipments above consumption in fiscal 4Q. I don't know if I picked that up correctly.

Mark A. Clouse

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

A

Yeah.

David Palmer

Analyst, Evercore ISI

Q

Yeah. And...

Mark A. Clouse

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

A

Yeah. No, I – yeah, I – we're low, is what I would say. I mean, obviously, it depends a little bit on the category that you're speaking to, but I would tell you, versus our historical position, in particular, given the pressure that we experienced in January and, again, I will say that we are already seeing some recovery in that as we go forward.

But the reality is, I think on many of our businesses, and you see it again like, I think, a great proxy for people to watch the development of our supply and availabilities is through TDPs, which almost to the item, if you will, or to the brand winds up with the share challenges and the percent loss in distribution.

And conversely, where you see that beginning to recover is where you see the return to kind of more normal levels of share growth and performance. And so, I think, as you see that recover, come back into full inventory,

the combination of those things together are going to be a nice tailwind for us to give you a little bit greater confidence that we're going to be in that positive territory.

And I think, as I said before, I think it will take us likely through till Q4 until you're kind of more fully loaded, if you will, across the board. But I do think you're going to see recovery in Q3 and likely opportunity to shift perhaps ahead of consumption even as early as parts of Q3.

David Palmer

Analyst, Evercore ISI



Thank you.

Operator: We have now reached the allotted time for questions today. This will conclude today's conference call. Thank you for participating. You may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2022 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.