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CPB - Q2 2016 Campbell Soup Co Earnings Call

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OVERVIEW:

Co. reported 2Q16 net sales (as-reported) of $2.2b. Adjusted EPS for 1H16 was $1.82 and 2Q16 was $0.87. Expects FY16 net sales to be negative 1% to 0%.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Campbell Soup second-quarter 2016 earnings conference 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 - IR*

Thank you, Stephanie. Good morning, everyone. Welcome to the second-quarter earnings call for Campbell Soup's FY16. With me here in New Jersey are Denise Morrison, President and CEO; Anthony DiSilvestro, CFO; and Blake MacMinn, Senior Manager Investor Relations.

As usual, we've created slides to accompany our earnings presentation. You will find the slides posted on our website this morning, at investor.campbellsoupcompany.com. This call is open to the media, who participate in a listen-only mode.

Today we will make forward-looking statements which reflect our current expectations. These statements rely on assumptions and estimates which could be inaccurate and are subject to risk. Please refer to slide 2 or our SEC filings for a list of factors that could cause our actual results to vary materially from those anticipated in forward-looking statements. Because we use non-GAAP measures, we have provided a reconciliation of these measures to the most directly comparable GAAP measure, which is included in our appendix.

With that, let me turn the call over now to Denise.

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

Thank you, Ken. Good morning, everyone, and welcome to our second quarter earnings call. Today I will share my perspective on our performance in the quarter and our progress on the strategic changes we've implemented at Campbell over the past year.

Overall, I'm pleased with our results this quarter, but not satisfied with our sales performance. We delivered outstanding adjusted EBIT and EPS growth. I'm particularly happy with our continued gross margin expansion, improved execution from our supply chain team, and the progress we've made on our cost savings initiative. Organic sales for the quarter were comparable to a year ago, a bit below our expectations, as our categories and geographies continue to face challenging conditions.

As I discussed last week at CAGNY, the macroeconomic conditions are challenging in many of the markets where we have operations. In the United States, consumer spending remains cautious. In other parts of the world, financial capitals are grappling with the weakening economies and increased volatility.

We recognize that sales growth in many of our center store categories has been a key challenge for Campbell. Driving profitable net sales growth remains an area of focus for our entire team.

Our supply chain execution continued to improve this quarter. We've now delivered four consecutive quarters of improved supply chain performance, dating back to the third quarter of FY15. As we head into the second half of the year, we expect to sustain this performance; however, we'll begin cycling our improved operations and the rate of improvement will likely come at a more modest pace.

I'm also extremely pleased with the over delivery of our three-year cost savings initiative. Through a combination of our organization redesign, the creation of our integrated global services group, headcount reductions, more stringent policies, and the implementation of zero-based budgeting, Campbell is becoming a leaner, more effective and more efficient company. In addition to lowering our cost base, we're seeing signs of cultural change, as employees treat every dollar as it were their own.

We're reaping the benefits of our cost savings efforts ahead of our expectations and we continue to identify additional savings opportunities. As a result, we increased our 2018 savings target to $300 million, up from the $200 million objective we set when we introduced the program one year ago.

We'll continue to invest a portion of these savings into our businesses, based on their portfolio roles and longer term growth opportunities that we've identified to create shareholder value over time. For instance, we plan to make several investments in the second half of the year in the areas of new product development and support for several of our key brands. Additionally, we are building new capabilities in areas such as e-commerce.

As announced last week, we raised our annual earnings guidance and now expect adjusted EBIT to increase to 13% and adjusted EPS to grow by 9% to 12%. We continue to expect the outlook for net sales to be in the range of negative 1% to 0%. The improved outlook for adjusted EBIT and adjusted EPS are primarily due to improved gross margin performance and the better than expected benefits of our cost savings initiative.

Now, I'd like to share my perspective on our segment results. Let's start with our largest division, Americas Simple Meals and Beverages. As a reminder, we are managing this division for moderate growth, consistent with the categories in which we operate, and for margin expansion.

As we've previously outlined, we're focused on increasing net price realization, including optimizing promotion spending and improving our supply chain performance. I'm encouraged by the progress we've made against all three of them. Organic sales declined by 1% in the quarter, predominantly driven by a decline in US soup sales.

As context, the entire Wet Soup category declined 3% for the 13 weeks ended January 31. Our soup sales, down 4%, were below our expectations, although we had some bright spots. Our Condensed Soup business was up for the quarter and our Broth business grew nicely. However, declines in Ready To Serve soup more than offset those gains.

Let me explain the factors at play. As we discussed back in the first quarter, we began taking steps to increase our net price realization through a combination of pricing actions and implementing more balanced promotion plans to support our business. As anticipated, these price realization activities had a negative impact on volume, but it was a necessary step to address the historical lack of price realization in RTS and strategically important for our entire Soup portfolio.

Another factor was the timing of our marketing plans. As we discussed in the first quarter, our marketing and merchandising support was planned for later in the year, across the end of the second quarter and into the third quarter. We also experienced some execution issues related to an on-label promotion on our Chunky brand. Finally, weather is not something we control and it's certainly not the main reason for the decline in our Soup business, but we believe the unusually warm winter had a negative impact on the entire category in the first half.

In January, we grew Soup sales in the high single digits, as we began to address our execution issues in Chunky, ramped up marketing activities, implemented more effective promotions, and benefited from more seasonal weather. Our plans will continue into the third quarter.

Despite these headwinds, we're taking steps to improve the performance of our US Soup business. Our pricing actions are taking hold. We've implemented more impactful promotion programs and our new advertising campaign is resonating with consumers. This bodes well for the future.

Beyond Soup, our Simple Meals business performed well in the quarter, with solid sales growth in Prego, Pace and especially Plum. We told you last July that our innovation plans in the Americas would focus on fewer, bigger ideas. In our quest to ramp up innovation, we recognize that some things will work and others will not. The key is to recognize it early and move on, and that's precisely what we're doing.

Overall, our innovation results are mixed. On the plus side, Campbell's Dinner Sauces platform and Slow Kettle soups continue to grow and are over indexing with millennials. Campbell's Organic Soup line is meeting expectations and helping us expand our health and well-being options in the center store. In our Beverage business, we are pleased with V8 Veggie Blends and V8 Plus Energy. Finally, the innovation driving the expansion of our Plum portfolio is robust, as this brand continues to build loyalty with millennial parents.

Now, let's look at what's not working as well. Pace and Prego Ready Meals and Campbell's Fresh Brewed Soups in K-Cups are performing below expectations, and we're taking steps to evaluate the root cause and course correct. Additionally, we've discontinued the V8 Protein line. Our key learning was that these shakes and bars were not differentiated enough to succeed in a crowded and competitive space.

We've recently hired Greg Shewchuk as our new Chief Marketing and Commercial Officer for the Americas division. With his extensive experience, we expect he will lead accelerated marketing innovation and sharpen our focus on fewer, bigger initiatives. We're excited to welcome Greg to the team in early March.

Clearly, the highlight in the Americas division was the significant gross margin expansion and the 22% increase in operating earnings. A major improvement this quarter was our supply chain performance. In addition to our ongoing productivity programs, we improved our execution in transportation and warehousing. We also benefited from the benign inflationary environment. Overall, our Americas Simple Meals and Beverages division continues to make progress in delivering against its portfolio role.

Moving on, our Global Biscuits and Snacks division performed well in the quarter, delivering organic sales growth and driving significant profit. This division unifies our Pepperidge Farm, Arnott's and Kelsen businesses, and its portfolio role is to manage growth while improving margins in both developed and developing markets.

Our core developed markets of Australia and the United States continued to deliver positive results. I'm pleased with the performance in our US Biscuits and Bakery business, with sales growth across numerous Pepperidge Farm categories, including fresh bakery, frozen and cookies. Looking ahead, we have solid innovation plans in place in our core developed markets, with new products in the US, such as the launch of artisan rolls and the introduction of Goldfish Crackers with organic wheat. In Australia, we're restaging our Shapes product line to increase the flavor of these popular snacks.

Turning to developing markets, excluding the impact of currency, sales growth in Malaysia was offset by the declines in Indonesia, where economic conditions remain challenging. While we are expecting the Indonesian economy to improve in the second half of the year, we don't expect our business to return to growth this year.

In China, our primary focus has been the Kelsen business. We've made many changes to improve this business since acquiring it in August, 2013. At the end of FY15, we changed distributors, added new marketing and digital talent, and began ramping up our sales force.

We had a solid sell-in for the Chinese New Year, our biggest and most important season. And our new distributors delivered strong execution, including merchandising supported by our new integrated marketing campaign. As I discussed last week at CAGNY, we believe it's important for Campbell to become more geographically diverse, despite short-term volatility in developing markets.

Turning now to Campbell Fresh. C-Fresh includes Bolthouse Farms, Garden Fresh Gourmet, and our Refrigerated Soup business. This division's portfolio role is to accelerate sales growth and expand into new packaged fresh categories. Reported segment sales increased 10% in the quarter. Excluding the impact of the Garden Fresh Gourmet acquisition, sales were comparable to a year ago.

In Bolthouse Farms, we delivered mid-single digit sales growth in beverages and double-digit gains in refrigerated salad dressings. Carrot sales were down slightly, although we grew share. We continue to drive growth in the faster growing organic segment of the carrot market, and we're taking steps increase our presence there. As reminder, one of the key roles of our market-leading carrot business is to provide the refrigerated logistic system and scale in the perimeter that we can leverage for distribution and merchandising of our CPG business.

Our Carrot Ingredients business remains challenged, with a significant decline in the quarter related to reduced export demand from Japan. As expected, the rate of decline moderated in the quarter and we expect that trend to continue in the back half of the year.

We're happy with the margin expansion in C-Fresh and the increased operating profit. We've invested in capacity, enabling us to increase our in-house production. We've rationalized unproductive beverage SKUs. We've increased our supply chain productivity and we've managed SG&A. However, C-Fresh's portfolio role is full force growth and we expect stronger topline performance from the CPG portion of this business.

Looking ahead, we expect improved sales growth in C-Fresh in the second half of the year to be driven by stronger performance in the CPG business and moderating declines in Carrot Ingredients. We have one of the strongest Spring innovation efforts in several years. We'll add 14 new items across beverages and salad dressings, including six new varieties of 1915 by Bolthouse Farms, our ultra-premium cold-pressed organic juice line. With our increased capacity coming online this month, we expect to expand our ACV distribution of 1915 to 50% this year, largely in line with the category.

The integration of Garden Fresh Gourmet and our retail perimeter soup business into C-Fresh is progressing well. Sales of retail soup were up modestly in the quarter, and Garden Fresh Gourmet is tracking to deliver the sales we expected through increased distribution and increased market penetration.

We've accomplished a great deal over the last 12 months, as we've aligned our enterprise structure with our strategy, created three new divisions with strong leadership, defined clear portfolio roles, and implemented a major cost savings initiative. We're now better positioned to execute our strategies and to invest in the areas of our business that hold the greatest growth potential, including several investments in the second half of this year.

Against this backdrop, I'm encouraged by our performance this quarter. Our enterprise redesign and cost savings efforts are delivering better than expected results and our new divisions are beginning to perform in line with their portfolio roles. But we remain unsatisfied with our top line growth, and I know we can do better. We expect to improve our growth profile in the second half, and we continue to stay focused on driving long-term, sustainable, profitable net sales growth.

I look forward to answering your questions, but now let me turn the call over to our Chief Financial Officer, Anthony DiSilvestro.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

Thanks, Denise, and good morning. Before getting into the details, I wanted to give you my perspective on the second quarter.

At the top line, organic sales, which were comparable to last year, were below our expectations, reflecting the sales performance of US Soup. We made outstanding progress on gross margin, up 4 percentage points on an adjusted basis, benefiting from our price realization actions and supply chain performance. Our cost savings initiatives are delivering significant benefit, $50 million in the second quarter and as we shared at CAGNY last week, we've raised our three-year savings target to $300 million, with these savings impacting multiple P&L lines. Based om on our gross margin performance and incremental cost savings, we also raised our full-year earnings guidance last week and I'll provide more detail in a moment.

Now I'll take you through the detailed results and our 2016 guidance. For the second quarter, net sales on an as reported basis declined 1% to $2.2 billion, primarily due to the negative impact of currency translation. Excluding currency and the impact of the Garden Fresh Gourmet acquisition, organic net sales were comparable to the prior year, as gains in Global Biscuits and Snacks were offset by declines in Americas Simple Meals and Beverages.

Reflecting a 4 point increase in operating margin, adjusted EBIT increased 26%, to $423 million, benefiting from a higher gross margin percentage and savings from our cost reduction initiatives. These positive drivers were partly offset by higher incentive compensation costs, currency translation, which had a 3 point negative impact, and lower volumes. Adjusted EPS increased 23%, to $0.87.

For the first half, net sales on an as reported basis were down 2%, while organic sales were comparable to the prior year. Adjusted EBIT increased 24% and adjusted EPS of $1.82 was up 21%.

Breaking down our sales performance for the quarter, reported sales declined 1%, with organic sales comparable to the prior year. Within organic sales, volume and mix subtracted 2 points, was primarily driven by US Soup within the Americas Simple Meals and Beverages segment. Higher selling prices contributed 1 point, while lower promotional spending also added 1 point, both driven by our net price realization efforts in Americas Simple Meals and Beverages and in Global Biscuits and Snacks.

Currency translation had an average impact of 2 points on the top line, as our two primary foreign currencies, the Australian dollar and the Canadian dollar, weakened against the US dollar. To complete the bridge, the acquisition of Garden Fresh Gourmet contributed 1 point to net sales in the quarter.

Our adjusted gross margin percentage increased by 4 points to 37.3%, exceeding our expectations on lower than anticipated cost inflation and better than anticipated supply chain performance. Compared to the year ago period within inflation and other, we experienced improved supply chain performance, primarily from transportation cost savings initiatives, as well as lower losses on open commodity contracts. In aggregate, inflation on input costs was close to zero.

Mix was slightly favorable, adding 20 basis points. Our net price realization actions contributed 1.4 points of margin expansion, with 50 basis points from reduced promotional spending, principally trade reductions in US Soup and Pepperidge Farm, and 90 basis points from higher selling prices.

Lastly, our supply chain productivity programs, which are incremental to our three-year cost savings program, contributed 180 basis points to margin improvement in the quarter. Recent capacity additions in Bothhouse Farms and US Broth, as well as our Soup common platform initiative, are contributing to these productivity gains.

Excluding items impacting comparability, adjusted marketing and selling expenses declined 5% in the quarter, primarily due to reductions in nonworking marketing from our cost savings initiatives, partly offset by higher advertising and consumer promotion expense driven by increases in Kelsen, Pepperidge Farm and US Soup. Adjusted administrative expenses increased 6%, primarily due to higher incentive compensation costs compared to a year ago, partly offset by benefits 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. As you can see, in aggregate, adjusted EPS increased $0.16 compared with the prior year, from $0.71 to $0.87 per share. On a currency neutral basis, growth in adjusted EBIT, mostly from the gross margin expansion and benefits from our cost savings initiatives, contributed $0.22 to EPS growth.

The impact from share repurchases under our strategic share repurchase program reduced our share count slightly, but had no impact on EPS for the quarter. And while net interest expense increased $2 million as we extended the maturity on the debt portfolio in FY15, this also had no impact on EPS for the quarter.

Going the other way, our adjusted tax rate for the quarter was 31.6%, up 2.8 points versus the prior year, primarily due to lapping the favorable resolution of an intercompany pricing agreement which negatively impacted EPS by $0.04. Currency had a $0.03 negative impact on EPS in the quarter, completing the bridge to $0.87 per share.

Now, turning to our segment results. In Americas Simple Meals and Beverages, organic sales decreased 1% to $1.2 billion. US Soup sales decreased 4%, driven by declines in Ready To Serve Soups, partly offset by gains in Broth and Condensed Soup. Sales of other US Simple Meals increased, driven by gains in Plum, Prego pasta sauces, and Pace Mexican sauces.

Sales of US Beverages declined, primarily due to weakness in V8 V-Fusion beverages. Excluding the negative impact of currency translation, sales in Canada decreased, driven by declines in Soup. Operating earnings increased 22%, reflecting a higher gross margin percentage which benefited from net price realization, productivity gains and improved supply chain performance.

Reflecting declines in Ready To Serve Soup, total US Soup sales declined 4%, driven by category declines from warmer weather, the volume impact from our pricing actions, the timing of our marketing programs, and an issue with on-label promotion on Chunky, which has since been corrected. Within US Soup, RTS declined 20%, which was partly offset by a 7% gain in Swanson Broth and a 2% gain in Condensed. We began and ended the quarter with retailer inventory in aggregate comparable to year-ago levels.

As we said last quarter, we do not believe sub category sales performance is a meaningful disclosure. We will continue to provide it through the fiscal year before discontinuing in 2017.

Here is a look at US Wet Soup category performance and our share results, as measured by IRI. For the 52-week peak period ending January 31, 2016, the category as a whole declined 1.9%. Our sales in measured channels declined 2.8%, with weakness in Ready To Serve and Condensed Soups partly offset by strength in Broth.

Campbell's had a 59% market share, a decline of 50 basis points. Private label grew share by 20 basis points, finishing at 13%. All other branded players collectively had a share of 28%, up 30 basis points, reflecting share gains by smaller brands.

In Global Biscuits and Snacks, organic sales increased 2%, with growth in Pepperidge Farm and the Asia-Pacific region. Sales gains in Pepperidge Farm were driven by fresh bakery, frozen products and cookies. Sales of Goldfish crackers were up slightly for the quarter, with modest share gains for the first half of the fiscal year.

In the Asia-Pacific region, excluding the impact of currency translation, growth in Australia, driven by Arnott's Tim Tam biscuits, was partly offset by declines in Indonesia, as that market continues to face economic challenges. Operating earnings increased 23%, primarily driven by a higher gross margin percentage which benefited from net price realization and productivity gains, partly offset by the negative impact of currency translation.

In the Campbell Fresh segment, organic sales were comparable to the prior-year, with gains in Bolthouse Farms premium refrigerated beverages and salad dressings which, on a combined basis, grew mid-single digits, offset by declines in Carrot Ingredient export sales and declines in retail carrots, despite gaining share. Not included in organic results is our recent acquisition, Garden Fresh Gourmet, which contributed 10 points of sales growth to the segment.

Operating earnings grew 62%, to $21 million, driven by a higher gross margin percentage which benefited from improved supply chain performance, productivity improvement, and the favorable mix impact from growth into higher margin refrigerated beverages. This performance resulted in a 2 point improvement in operating margin for the segment compared to a year ago.

We had strong cash flow performance in the first half. Cash from operations increased by $143 million to $727 million, driven by higher cash earnings and lower working capital requirements.

Capital expenditures increased $10 million, to $153 million. We continue to forecast CapEx of approximately $350 million for FY16.

We paid dividends totaling $197 million, reflecting our current quarterly dividend rate of $0.312 per share. In aggregate, we repurchased $86 million of shares in the first half, $50 million of which were under our strategic share repurchase program. The balance of the repurchases were made to offset dilution from equity-based compensation.

Net debt declined by approximately $150 million, as positive net cash flow generated by the business more than offset the impact of the $232 million acquisition of Garden Fresh Gourmet.

Now, I will review our 2016 guidance, which is consistent with our news release on February 16. We expect sales to change by minus 1% to 0%, including a 1 point benefit from the acquisition of Garden Fresh Gourmet and a 2 point negative impact from currency translation, as compared to the previous estimated currency impact of 3 points. This sales guidance implies a reduction in organic sales compared to our previous guidance, reflecting the performance of US Soup. Benefiting from gross margin performance and incremental cost savings, we expect adjusted EBIT to grow by 10% to 13% and adjusted EPS to grow by 9% to 12%.

Our full-year guidance implies a modest earnings decline in the back half of the year. This reflects investments we are making in new product launches, higher marketing spending, and headwinds from higher incentive compensation, and the negative impact of currency on the input costs of our international businesses.

We expect adjusted gross margin to expand by approximately 175 basis points, driven primarily by our first half performance. In the back half, we anticipate headwinds from increased promotional spending to support new products in key brands, the negative impact of currency on the input costs of our international businesses, and from modest cost inflation. Offsetting these headwinds, gross margin will benefit from our cost savings initiatives and productivity gains, but we will be wrapping much of the pricing and improved supply chain performance we experienced in the first half.

Against our cost savings program, we expect to deliver savings in the range of $120 million to $140 million in 2016, compared to our previous range of $80 million to $100 million. As announced last week, we have increased our 2018 annual savings target from $250 million to $300 million. Also, we expect the full-year adjusted tax rate to be approximately 33%.

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

Ken Gosnell - *Campbell Soup Company - IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ken Goldman, JPMorgan.

Ken Goldman - *JPMorgan - Analyst*

Denise, you talked about your desire to continue growing in emerging markets via M&A, and I think the phrase you used to describe the EM situation was -- and correct me if I'm wrong -- short-tem volatility. My question is, how do we know? How are we confident that the issues are not permanent slowdowns over there? Because I'm trying to get a sense of Campbell's willingness maybe to spend on an asset in a geography less attractive than it once was versus your other M&A goal, which is faster growing domestic assets. Some of these that have been sold lately -- Vega, I think, is one of them --I would have thought Campbell might have been very interested in.

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

We expect that the emerging markets that we currently have footholds in, and that is China and in Southeast Asia, will continue to be viable markets for our business, particularly our Global Biscuits and Snacks business, which is growing despite the fact that their overall growth rates are down, particularly in China. We do think that even though their growth rates have slowed, they're still growing faster than domestic market. And we also know that 70% of the growth in the food industry is going to come from emerging markets over the next decade. So we believe we need to continue, in a smart way, to expand our geographic footprint. That said, we'll continue to look for smart M&A, both in emerging markets and also domestically, in sync with our strategy.

Operator

Chris Growe, Stifel.

Chris Growe - *Stifel Nicolaus - Analyst*

I wanted to ask a question, if I could, in relation to -- you've got a heavy degree of cost savings coming through and really influencing your gross margin. Maybe two questions related to that. One is, do you have -- and if I missed this, excuse me -- but a gross margin guidance for the year now? It looks like that's really running well ahead of your expectations. And then in relation to that, you talked about increasing your marketing investments in the second half of the year. I had planned for you to do that anyway. Are you stepping those up? Are we seeing the investment levels increase from what you'd assumed initially for the year?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I'll take that one. I'll comment first on the gross margin comment. Yes, we are giving guidance on gross margin and we expect a 175 basis points of gross margin improvement for the year. So that implies about a flattish back half. But let me try to give you some more context on this one. I think if you go back to last fiscal year, 2015, it really is a story of two halves. In the first half of last year, gross margin was down about 2 points. And in the second half of last year, gross margin was up 1.4 points, as we took some pricing and improved our supply chain performance in the back half.

So if you look at it on a two-year basis, both the first and second half of this year are each up just over 1 point versus two years ago. And the reason we're flat in the back half is a couple of things. There are a couple of headwinds. One is higher promotional spending to support some new product launches and some key brands. And as I mentioned in my comments, the negative impact of currency on costs, so both our Australian business and Canadian business have a significant portion of their inputs are denominated in US dollars. And we were hedged for a while, but we're closer to market now in those currency impacts. So that's having an increasing impact. And we still have a little bit of cost inflation, although it's more moderate than certainly we had initially expected. And we believe we'll be able to offset all of that impact with continuing productivity gains and the benefits of our cost savings program.

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

Chris, I will take the second part of that question. As our cost savings have materialized earlier than expected, we are also accelerating our investments, where it's prudent to do so. So it's very choiceful and it's across all three of our divisions. So in C-Fresh, we're going to be supporting our strongest innovation effort in several years, with 14 new products, including new varieties of 1915. In Global Baking and Snacking, we're investing in Goldfish with the launch of Organic Wheat Goldfish. We're investing in Tim Tam and the relaunch of Shapes in Australia. And then in the Americas, we still have marketing activity that, remember, we staged later in the year to support our Soup and our Beverage businesses, as well as product launches across Simple Meals and a robust pipeline for Plum Organics. So we have a lot of activity planned in the second half, and this does reflect an acceleration.

Chris Growe - *Stifel Nicolaus - Analyst*

That's very helpful. Thank you for your time.

Operator

Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

I wanted to ask about the declines in Ready To Serve. The first half of the year, they were pretty steep. And it's been like that for a couple of years now. And I wanted to know, Denise, how are you going to balance the portfolio strategy mandate to run Soup forward and to hold share, and also recognize that you might need to put more investment into Ready To Serve to stem those declines. Do you need to fix the product, or do you need to change something on the promotional strategy which ended up causing some elasticities that were bigger than you thought? What do you think?

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

First of all, when you step back, the entire Web Soup category was down 3% and we were down 4%. We were up in Condensed by 2% and up in Broth by 7%. In RTS, particularly in Chunky is where we experienced our issue. And recall, we did take net price realization. So that's a combination of pricing actions and also promotion actions. And that's not an easy one, because you've got a marketplace where some of the marketplace is at high-low on promotions and some of it is EDLP. So finding that right rhythm is an important idea. The other thing is the competitive landscape. We have to take that into consideration, as well.

In the case of Chunky, we actually had a promotion [on-pack] label that caused consumer confusion and we are largely out of that right now. So that one is behind us. And then finally, we launched a portfolio campaign which really helped our condensed soup, but it did not do the job on brand Chunky. And so it wasn't until later in the quarter that we came with dedicated advertising, and that will continue into quarter 3. And again, I'm not really one to give the weather report, but it really was, relative last year, a much warmer winter.

So we really expect Soup to grow modestly, consistent with other center store categories. We are continuing to invest in the Soup business and we are continuing to invest in the quality of the product. So it's not any one silver bullet, it's a combination of things.

Robert Moskow - *Credit Suisse - Analyst*

Can ask a follow-up to that? Did you have a different promotional strategy for Condensed then you did for Ready To Serve, or maybe more aggressive promotions on Condensed?

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

Each segment of the Soup business, we have a different promotion strategy, and we work in joint business planning with retailers on the right execution to get the best return for the investment.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

What we had on Chunky was moving up on the promoted price points, more so than the other categories inside of Soup.

Robert Moskow - *Credit Suisse - Analyst*

That's what I was looking for. Thank you, Anthony.

Operator

Jason English, Goldman Sachs

Jason English - *Goldman Sachs - Analyst*

Thank you for the question. Congratulations again on a solid first half. You spent a fair amount of time, Denise, in your prepared remarks talking about some of the challenges in terms of find growth in this portfolio, some of the innovation, and you talked a little bit about M&A. Can you delve a little bit deeper in terms of your appetite for M&A in your efforts to transform this portfolio? Is there an increased sense of urgency, given the organic challenges, and what are you seeing out there in the landscape in terms of quality assets at reasonable prices?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I'll start and then see where we go here. I think the first point to make is that we are confident that the portfolio today can deliver long-term sales in that 1% to 3% range on a currency neutral basis. And I think if you think about the portfolio roles that we've assigned to each of our divisions, Americas Simple Meals and Beverages, moderate growth in line with the category. We have a very good portfolio in Global Biscuits and Snacks. That should certainly be able to grow towards the high end of that range. And then C-Fresh, the performance of late has not been that great. And there's some reasons for that and we're going to lap some of those reasons. So we do expect much better top line growth out of Campbell Fresh than we've seen to date. So I think if we just think about portfolio that we have, we do expect that to grow.

On the other hand -- and we pointed this out at CAGNY -- we've made some good progress diversifying the portfolio and getting into higher growth spaces. We've done four acquisitions, as you know, over the last few years, and we will continue to look for opportunities to push further into higher growth spaces. That being said, we continue to be disciplined in how we approach M&A. Deals have to be strategically compelling, they have to be financially attractive, and they have to be able to create shareholder value for us. So we'll continue to do that and see how we go.

Jason English - *Goldman Sachs - Analyst*

Any comments on the M&A environment?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

No. I think it's still pretty rich. The multiples are still pretty high. That being said, like I said, we have a pretty diligent effort in the area, a group of people looking at it. We have a pipeline. It's not a long, long list of opportunities. It's fairly tight. We continue to build relationships with companies that are perhaps family owned or private. And we'll just continue to work it.

Operator

David Driscoll, Citigroup.

David Driscoll - *Citi Research - Analyst*

Denise, I wanted to follow up, I think a couple people have asked this question a little bit, but I want to try it slightly differently. Americas Simple Meals, just the volume outlook. Clearly, you talked about the warm weather in the quarter. And then there's a much bigger picture issue here of just how you've resegmented the Company, and I want to call it manage for cash, meaning that net pricing is going to trump volume trends. I was hoping you could just talk about how, over the course of time, the volume should trend within this segment and what's the strength of this concept that the Company would accept better profits and maybe incur some negative volumes. What's the tolerance to accept an outcome like that, that the margin performance in the quarter, incredible in that segment, and obviously you're being rewarded for it in the market today, but just like to hear your thoughts longer term.

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

I think longer term, we expect to strike the right balance of net price realization and volume, and we'd like to grow Soup and Simple Meals modestly over time. That's in line with the expectations for those categories. So that portfolio role was thought through very carefully. And what we've learned over the years is when we expect the categories to grow beyond what their portfolio momentum can do, we wind up spending inefficiently to get there. And so it's really an important idea to make sure that we are investing appropriately to be competitive in those categories and drive modest growth, while we keep an eye on our margin expansion.

David Driscoll - *Citi Research - Analyst*

The one follow-up on this point, Denise, is simply that I think you said yourself that pricing in the category, in the Soup category, especially in RTS, has just not been there for, I think you said, a decade, or some really long period of time. Why would it be natural to assume that the volume growth should be like the rest of the store, if in fact, this category should be taking pricing to catch up relative to what it hasn't done in this previous decade?

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

Each segment of the category has its competitive set and we run the Soup business as a portfolio. And so when you think about the pricing spectrum in the portfolio, it's all the way from value condensed through higher end slow kettle, and even into higher than that end, refrigerated soup, and then mainstream pricing in between. And so actually, we think that the price realization on RTS was an important idea in portfolio management of the category. And we saw positive results on the Condensed Soup line this quarter.

Operator

John Baumgartner, Wells Fargo.

John Baumgartner - *Wells Fargo Securities, LLC - Analyst*

Denise, I'd like to come back to the Ready To Serve topic. You called out some of the elasticity impacts there on the quarter, but your price gap relative to your largest branded competitor, I think the widest it's been in a couple of years now. How impactful do you think that gap on the shelf has been to your (Indiscernible), and might this be a situation where an increase in promo may end up being necessary to stabilize things?

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

I do think that when we planned our net price realization for the year, we did not expect competition necessarily to follow. However, we did notice more of a gap, particularly on promotions, than we had planned for. So we are, of course, correcting accordingly.

John Baumgartner - *Wells Fargo Securities, LLC - Analyst*

Is this a situation that we should think that it continues to weigh on volume in the back half of the year, as well?

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

Actually, we have a pretty robust plan of starting in the latter part of Quarter 2, in January, and all through Quarter 3. And we were very pleased with the results in January.

Operator

Alexia Howard, Bernstein.

Alexia Howard - *Bernstein - Analyst*

Can I ask about the sales investment? I think, looking at the press release, it looks as though there might have been some cutbacks on the selling side of things, if marketing spending was up a bit. What are you doing there? I know that a few years ago, you outsourced merchandising to (Indiscernible). Do have people in the stores merchandising? What is your strategy? Are you pruning that? Where are you heading?

And maybe also just generally on the promotional spending, I know it's already come up, but are you in general trying to pull back on the trade promotion spending where it's inefficient, and where is that likely to head over time?

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

We did have higher advertising spending in the quarter and we continue to invest in advertising and brand building, and you'll see that continue into the second half. In terms of trade investment, again, we focus on net price realization, which is the combination of pricing actions and promotion spending. We've created a revenue management group, which is working with advanced analytics to improve our effectiveness and make sure we take into consideration those programs that are working and not repeat those that aren't. So that's a change for us.

And finally, we always are looking to invest our promotion investment with customers for a better return. So a better return for them and a better return for us. So we are focused more on how we increase the quality of our spending. And basically, it's the combination of ACT that we expect to be between 24% and 25% of sales. That hasn't changed.

Anthony DiSilvestro - *Campbell Soup Company - CFO*

On the first part of your question, on selling expense size. It is down. And we went through a pretty significant reorganization. As we redesigned the divisions, we also reduced some of the staffing levels in some of our sales organizations, which is coming through, as well.

Operator

Matthew Grainger, Morgan Stanley

Matthew Grainger - *Morgan Stanley - Analyst*

I wanted to follow up on the gross margin expansion, just from a bigger picture standpoint. Given how significantly the magnitude of the upside has exceeded your original expectations this year, is it possible to talk a little bit more broadly about where you think gross margins can go over the next two to three years, given the continued flow-through of cost savings and the mix impact between the segments? And is this accelerated growth in 2016 in any way a pull forward of some of the gross margin expansion or reset that you'd hoped to achieve over a multi-year period?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I can take that one. Certainly, we are very pleased with the cost savings we've been able to achieve and our gross margin performance. And I think one way to look at that is we are planning to invest some of those savings, and we're going to start to see that in the second half, in new product launches and in key brands and longer term innovation ideas, capability building in areas like digital and e-commerce.

That being said, we've raised our savings target. So we think there's more savings to capture. That should benefit gross margin, as well as overhead costs. And I think that, together with the role of Americas Simple Meals and Beverage, targeting margin expansion, so we think there's enough funding there to do a couple of things. One is to make these investments in the business and to continue to target achieving our long-term growth objectives of 1% to 3% sales, 4% to 6% EBIT, and 5% to 7% EPS. So I think we feel good about where we are and continue to plan to grow from there.

Matthew Grainger - *Morgan Stanley - Analyst*

Can I ask one follow-up, just with respect to the long-term targets? You're now targeting 10% to 13% EBIT growth this year. Given all the investments that you're planning to make, I'm just curious why perhaps you didn't choose to reinvest more aggressively during the second half to facilitate even higher visibility towards those targets over the next year or two. Is that just an issue of near-term constraints and how quickly you can implement the types of things you'd like to do?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

That's exactly right. We have a pretty disciplined process for making these types of investments. And the cost savings came in faster than we expected, and we couldn't turn on a dime that quickly to reinvest. We're starting to see some of it in the back half and we'll continue to see that into FY17. But it's difficult to move that quickly on the investment side.

Operator

Jonathan Feeney, Athlos Resource.

Jonathan Feeney - *Athlos Research - Analyst*

Just to clarify, on the pacing of these cost savings, can you repeat where we are year-to-date against the 110 to 120 target and what sort of run rate you think you're on right now as far as achieving those in the second half of the year? And also, a detail around that, if you wouldn't mind, could you give me a sense how those split between cost of goods sold and what marketing and selling and G&A and other expenses?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I'll take that one. Against the now $300 million, target we did $85 million last year. We did $30 million in the first quarter, and we did $50 million in the second quarter. So year-to-date first half, we are at $80 million against our incremental savings target this year of now $120 million to $140 million. So we're now two-thirds of the way into that. That $80 million comes from a combination of headcount and non-headcount, and that splits about evenly. In terms of P&L, it's about 33% COPS, 66% non-COPS. And within the non-headcount, a couple of examples of some of the big drivers would be travel and entertainment, non-working marketing. And on the cost side, some of our transportation cost savings initiatives, we redid our entire freight lane structure. And at the end of last year, we're seeing better rates. We're seeing almost no usage of the spot market. We're seeing better truck weights. We're seeing less miles. We're seeing less inter-plant shipment. So we're really seeing a lot of nice benefit on the transportation and warehousing side coming through, too.

Jonathan Feeney - *Athlos Research - Analyst*

Would you say that was the biggest area that came in ahead of your plan?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

No. It's across the board. Each area is well ahead of what we initially or previously thought.

Operator

David Palmer, RBC Capital Markets.

David Palmer - *RBC Capital Markets - Analyst*

A follow-up on the issue of reinvestment. You heard the surprising kudos on the cost reduction at CAGNY. And there was also some curiosity in the crowd about what if reinvestment would work longer term. Today, you're talking about marketing tactics with Chunky and the ramp up in marketing and promotion spending into the second half of the year. But as you think long term, what are the things that you think will -- what areas of reinvestment do you think you'll make in the core to change the trajectory of the core Soup and other?

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

It's a great question. And it's always been our intention to spend back a portion of the cost savings that we're realizing for the long-term health of the business. Let me give you some examples. In the Americas, even though we're managing Americas for modest growth and margin expansion, the Americas still has some pockets of full force growth businesses. And we will continue to invest, first of all, in the quality of our products and making sure that we're looking at ingredients and the quality against our purpose of real food that matters for life's moments. Second of all, we continue to invest in our Sauces business, which is really healthy, and our Broth business. And then finally, having made the acquisition of Plum Organics, we're incredibly pleased with the performance of that business and see a lot of runway in the innovation pipeline to make smart investments and continue to cultivate relationships with millennial parents.

In the Global Biscuits and Snacks front, we are very committed to expanding the Kelsen business in China and beyond. We have plans for increasing our footprint of the Tim Tam brand. And as I mentioned, we are continuously working on product quality, for example, the investment we're making back in our Shapes business. We are, in the United States, continuing to work on our Goldfish brand. And we believe there's more growth in that brand particularly, as we move into products in the health and well-being space.

And then finally, C-Fresh is our full force growth. And we've been very pleased with the portfolio of brands and categories, both in the produce area and in the deli part of the perimeter. Inclusive of our refrigerated soup, between the beverages, the salad dressings, the hummus, the salsas, and the soup, we have a lot to work with and we have capabilities in each one of those categories in shelf stable that we can actually bring into the fresh space. And we have a very energized team across all three of these divisions to do so.

So I think based on five years ago, we have a lot more to work with. And so making sure that we make smart investments and have a discipline about it is important, but we have a lot of places where we can put our dollars.

David Palmer - *RBC Capital Markets - Analyst*

Very helpful.

Operator

Michael Lavery, CLSA.

Michael Lavery - *CLSA - Analyst*

I was wondering if you could help me understand some of the cost savings break down a little bit further. You have your administrative expenses actually up 6% in the quarter and marketing down 5%. R&D, it looks like it's about like 9%. I would've thought that maybe you would see something closer to the reverse. And so what's the right way to think about that? And then how do you also reconcile the savings on the cost of goods sold side? How much of that is coming from input costs versus cost savings?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

First, on the admin expense. The primary driver of the increase is incentive compensation cost, last year below target, this year above target. Ex that, the admin would be down as a result of our cost savings initiative. So that's what you'd see on the P&L.

Inside of COPS, the inflation on input costs was about flat compared to a year ago. So it was neither a help nor a hindrance on gross margin, but it's certainly been more modest than it's been. And in COPS, what you're seeing is a few different things coming out of the supply chain and breaking down into three chunks. One is it's just better supply chain performance. And what we mean by that is that the plants are operating at higher efficiency levels, our customer service levels are back above our targets, and as a result, we see lower inter-plant shipments, we see fewer less than truckload shipments. So we have better weights. We have actually have less miles. So that's all within how we're operating.

And then we have a portion of our cost savings initiative that's coming through. And this is primarily in the area transportation and in the fact that we reworked our entire transportation network last year. So we've re-contracted it. We have increased the committed carrier capacity. At the same time, we've achieved lower rates. And as a result of our service levels being where they are, we really had almost zero use of the spot market. So that's a premium cost we had last year we don't have this year.

And the third bucket is what we call productivity, where we have specific actions the supply chain is taking to generate cost savings. And a couple examples within that would be the capacity additions in Bolthouse Farms and in our US Broth business have allowed us to repatriate production from co-packers, so we're seeing that benefit come through. The other one is our Soup common platform initiative, which we're also seeing benefit on the P&L. And lastly, warehousing capacity. We've made some investments in our own internal warehousing, so we've reduced our reliance on third-party warehouses, and some of those cost reductions are coming through, as well.

Michael Lavery - *CLSA - Analyst*

That's helpful. A quick follow-up on the marketing and R&D. How much of the change is pacing versus how much is driven by headcount or more permanent reductions?

Anthony DiSilvestro - *Campbell Soup Company - CFO*

I don't have that number off the top of my head here. Certainly, we are seeing fairly significant savings in non-working marketing coming through that line. And as Denise said, advertising, consumer spending is actually up in the quarter. But you see marketing expense on the P&L, and we don't see -- it's within selling and marketing -- is down. And that's primarily driven by all the work we've done on the cost savings side, both headcount and some of our other non-working marketing expenses.

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

And on the subject of R&D, because we continue to emphasize improving our innovation, we have brought in strong leadership. In our redesign, our product development is embedded in the business divisions, with strong support from the center. So we believe we have a very aligned organization to be more agile and more responsive in the marketplace.

Operator

Erin Lash, Morningstar.

Erin Lash - *Morningstar - Analyst*

I was hoping you could provide a little bit more detail surrounding the relationship with retailers and how those conversations are going as you're working to improve the efficiency of your trade and marketing spending. Obviously, retailers are dependent on leading brands to drive store traffic. And so you've highlighted the competitive dynamics being extremely intense over the course of the call. So I'm just wondering how those discussions are progressing and trending?

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

We engage with our retailers on joint business planning, where we will work with them on understanding their goals and working on plans that deliver on their goals and our goals, and then set expectations and the appropriate spending to achieve those expectations. And then there's a very rigorous process along the way to engage them with what's working and what isn't working, so there's course correcting, et cetera. So we're really positive about the relationships that we have in order to plan and execute the business.

We're very engaged with retailers on revitalizing the center store. It has been sluggish and it is a major source of profit for retailers. And we believe that we've got the portfolio that not only can jazz the center store, but it also toggles into the perimeter, as well, because many of our brands in the center store are used conjunction with products that consumers will buy in the perimeter, as well. So we continue to work with them on those kinds of goals, and they're mutual goals. So the way we look at our trade is as an investment where we hope to continue to build a return on that investment by good planning with retailers.

Erin Lash - *Morningstar - Analyst*

Thank you. That's very helpful.

Ken Gosnell - *Campbell Soup Company - IR*

Thank you, everyone, for joining our second quarter earnings call and webcast. A full replay will be available about two hours after the call concludes by going online or calling 1-703-925-2533. The access code is 1668326. You have until March 10 at midnight, at which point we move our earnings call strictly to the website, investor.campbellsoupcompany.com, under News and Events. Just click on the webcast. If you have further questions, please call me, Ken, at 856-342-6081. If you are a reporter with questions, please call Carla Burigatto, Director of External Communications, at 856-342-3737. This concludes today's program. Thank you.

Operator

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