

05-Jun-2024

Campbell Soup Co. (CPB)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

Rebecca Gardy

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

Carrie L. Anderson

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

Mark A. Clouse

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

OTHER PARTICIPANTS

Andrew Lazar

Analyst, Barclays Capital, Inc.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Jim Salera

Analyst, Stephens, Inc.

Nik Modi

Analyst, RBC Capital Markets LLC

David Palmer

Analyst, Evercore ISI

MANAGEMENT DISCUSSION SECTION

Operator: Greetings, ladies and gentlemen, and welcome to the Campbell Soup Company Third Quarter Fiscal 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] As a reminder, this conference call is being recorded.

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

Rebecca Gardy

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

Good morning, and welcome to Campbell's third quarter fiscal 2024 earnings conference call. I'm Rebecca Gardy, Chief Investor Relations Officer at Campbell. Joining me today are Mark Clouse, Chief Executive Officer; and Carrie Anderson, Chief Financial Officer.

Today's remarks have been prerecorded. 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 the 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 our presentation.

Slide 4 outlines today's agenda. Mark will provide insights into our third quarter performance as well as our in-market performance by division. Carrie will then discuss the financial results of the quarter in more detail and outline our guidance for the full fiscal year 2024, which we updated this morning.

As a reminder, we completed the acquisition of Sovos Brands on March 12, and as such, third quarter and third quarter year-to-date financial results include a partial quarter of contribution of Sovos Brands.

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

Mark A. Clouse

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

Thanks, Rebecca. Good morning, everyone, and thank you for joining our third quarter fiscal 2024 earnings call. As we announced today, we had a solid third quarter with sequential volume improvement, stable organic net sales, double-digit year-over-year adjusted EBIT and EPS growth, while expanding margins.

The integration of the Sovos Brands is off to a fantastic start and has already added significant incremental growth to our company in the third quarter. We feel great about the confirmation of our diligence during the acquisition process and are excited about Sovos' long runway for growth.

We are also excited to be working with the many talented Sovos Brands' team members who have joined Campbell's. We saw stabilizing in-market performance on our base Meals & Beverage business, but faced some moderate category pressure in the Snacks business. However, we've seen improvement in the latest weeks and remain very confident in the continued consumer demand for snacking and the strength of our portfolio of advantaged brands.

Additionally, we are pleased with our continued Snacks operating margin progress. We are updating our fiscal 2024 outlook to reflect the addition of Sovos Brands and the ongoing pace of the consumer recovery. Carrie will provide further details on this guidance a bit later.

Turning to slide 7, organic net sales in the third quarter were comparable to the prior year period. As we expected, volume improved compared to the second quarter. Both adjusted EBIT and adjusted EPS increased by double digits with the recent acquisition having no material impact to adjusted EPS.

In-market consumption was down 2%, but up 6% versus two years ago, as we continue to normalize pricing and volumes. The 2 points of difference in organic net sales versus consumption was primarily driven by strength in unmeasured channels as foodservice and Canada both had strong quarters.

It is exciting to see the positive impact on the business from adding Sovos Brands. In Q3, on a pro forma basis, we see a 200 basis point improvement in top line and volume and mix growth. Looking at the now combined Campbell's, we would rank among the fastest volume-driven growth companies in the food sector over recent periods. As integration progresses, we expect to realize further top line and bottom line benefits.

I look forward to providing more details at our Investor Day in September about how this acquisition, when paired with the rest of our iconic portfolio, will fuel the next chapter of long-term growth for the company.

On slide 9, I want to go into more detail about the current consumer environment. Unquestionably, as prices have begun to moderate, consumers are starting to recover. This is substantiated by the first improvements in consumer confidence in a long time.

In addition, we are seeing significant growth in the percentage of the top-50 edible categories that are maintaining or increasing household penetration compared to the same period last year. Most importantly, we are seeing food volume stabilize as pricing normalizes. Yet, it is fair to say that the pace of this recovery has varied depending on the specific category and the consumer's income level.

For example, our Snacks business, which has been the most resilient to date, is now facing some short-term pressure, especially among lower and middle income consumers. We are seeing some modest improvement in the snacking segment in the most recent weeks, with the expectation of more of a full recovery in the first half of fiscal 2025.

Overall, we're staying focused on what we can control, with an emphasis on execution, innovation, and strong collaboration with our retail partners to remain relevant and win by meeting them both on quality and value. Growing and improving share trends along with stabilizing volumes are clearly a positive indication, and we expect that to continue going forward.

Moving to our Meals & Beverages division on slide 10, we achieved comparable organic net sales in the quarter. More importantly, we delivered volume improvement from the second quarter as planned. Organic net sales outpaced consumption, reflecting the strength in unmeasured channels. As mentioned earlier, this was primarily in foodservice and Canada.

As we look at Meals & Beverages on a pro forma combined basis with the addition of Sovos Brands, Meals & Beverages net sales grew 5%. Similarly, combined dollar consumption grew 3% for the quarter. This supports the ongoing transformation of our Meals & Beverages business and demonstrates the ability for this key business to be a positive driver of Campbell's growth going forward.

Now, let me briefly cover our soup portfolio on slide 11. We had an improvement in share on soup during the quarter fueled by improving trends across most key segments. In particular, as consumers continue to focus on stretchable meals, the cooking side of the portfolio benefited in the quarter, with notable dollar share gains in condensed cooking and broth. It's important to note that the industry has been experiencing some supply issues more broadly on broth.

Given the strength of our supply chain, we've been able to step up production to help meet that need, which has accelerated growth in this normally stable category. Although we expect industry capacity to return over time, it's adding significant new households for Swanson that we see as a positive indicator for the future.

In our ready-to-serve business, although more pressured as a segment, we now have Rao's ready-to-serve soup business under our umbrella, which had strong dollar share gains in the quarter.

Slide 12 illustrates that we have now surpassed one of our main strategic plan goals, which was to build \$1 billion sauce business. With the addition of the ultra-distinctive Rao's Italian sauce, Campbell's has strengthened its leading share position in the total Italian sauce category in terms of both dollars and units, gaining 3.1 points of unit share and 3.1 points of dollar share in the third quarter. Even more encouraging is the household penetration momentum we are seeing for Prego and Rao's with both increasing compared to the prior year.

On slide 13, we updated the slide we presented in August when we announced the Sovos transaction. As we had suggested at the time, there were many factors that support the potential for additional growth on Rao's. I'm happy to say almost a year later, we have seen the validation of those assumptions as we continue to progress toward our next \$1 billion brand.

I'm excited that Rao's is exceeding our expectations regarding household penetration and that we're seeing faster growth among younger consumers. The path ahead will continue to be fueled by household penetration gains and strengthening distribution and assortment. With innovation in adjacent categories as additional growth drivers, the future is bright.

Moving to frozen on slide 14, although not a particularly big bet in our growth model, it was encouraging to see the progress in the quarter. Our total frozen meal business maintained positive momentum with strong velocity increases as the team has optimized assortments and distribution, and with the continued strong performance from our expanding frozen pizza portfolio, we continue to see strong potential in this business.

Overall, we continue to be encouraged by the success of Rao's disciplined and thoughtful brand extensions, and we'll provide a comprehensive update on our plans going forward during our upcoming Investor Day.

I'll wrap up my remarks on the Meals & Beverages division by discussing noosa on slide 15. The noosa business has been one of the more positive surprises in the Sovos Brands acquisition. It is an excellent product and brand that continues to perform very well. In fact, in the quarter, the noosa spoonable business returned to dollar growth, driven by the success of its 8-ounce yogurt.

Additionally, the 8-ounce yogurt has now experienced 14 quarters of consecutive dollar consumption growth. Even though we have decided to explore strategic alternatives for the business as yogurt's not a strategic category for Campbell's, the business has truly exceeded our expectations. I am grateful to the noosa team for their tremendous focus and commitment. It is a well-run business with a dedicated team and great-tasting unique products.

Turning to our Snacks business on slide 16, organic net sales declined by 1%, slightly better than dollar consumption. On a two-year compounded annual growth rate basis, organic net sales increased 6%, matching dollar consumption growth for the quarter. Our power brands increased net sales by 2%, following a 16% increase in the prior year, showing the continued resilience of brands like Goldfish and Late July, which increased net sales by 5% and 26%, respectively.

On a two-year compounded annual growth rate basis, our power brands grew net sales and dollar consumption by 9%. Now that our power brands represent two-thirds of our Snacks business, this is a great foundation for sustained growth going forward. The strength of the power brands in the quarter was tempered by declines in lower margin partner brands, contract manufacturing and fresh bakery. We look forward to our Investor Day where we can provide both a clear growth acceleration path for power brands and a clear path to further optimize the remaining parts of our current Snacks portfolio.

On slide 17, I want to provide some context on the slower trends in the snacking categories seen over these past couple of quarters, and add some proof points as to why we remain very bullish on the snacking occasion.

First, over the past three years, Snacks categories have been the most resilient across food, essentially reflecting very little, if any, price elasticity. Recently, we have experienced some slowdown as low and middle income consumers have sustained economic pressure for so long, it's finally impacting Snacks. However, even with this

category moderation, we're still averaging 8% consumption growth over the last three years, which is well above total food and historical Snack growth averages.

Second, the slowdown so far has been more modest compared to other edible categories, which is consistent with historical performance and learnings that Snacks meet a variety of consumer needs, including emotional support during difficult times making it more resilient than many other categories.

Finally, we're already seeing improvement as we enter the important summer holiday windows, where Snacks are the star of the show for backyard barbecues and entertainment. So, although I anticipate some continued pressure in the short term, we expect Snacks will recover over the next couple of quarters and are confident in our overall expectation for outsized growth in snacking over the longer term.

In fact, a couple of standouts in the third quarter were Late July and Pepperidge Farm cookies, fueled by innovation and great marketing. We spiced up our Late July portfolio with the addition of Scorchin' Sauce and Hawaiian Habanero just in time for the summer snacking season. Late July net sales in the quarter increased 26% compared to prior year as the brand displays remarkable momentum, supported by our great new product development, brand investment and execution.

On the sweeter side, we continue to drive strong levels of velocity in cookies with new innovations in our Pepperidge Farm Milano cookie portfolio, such as the launch of our London Fog limited time offering. Most importantly, our Pepperidge Farm cookies portfolio continues to grow buyers across all generations, a positive proof point that as consumers are more selective on how they spend their snacking dollars, our elevated brands are well positioned to win.

Slide 19 illustrates the continued margin progress in our Snacks business. On a two-year compound annual growth rate basis, year-to-date, Snacks organic net sales grew 7% and operating earnings increased 14%. This growth came with approximately 190 basis points of margin expansion.

Key drivers of this margin expansion are initiatives to optimize our network, better execution in our manufacturing facilities and disciplined spending. We expect to reach our 15% operating margin goal for the full year and are on track to reach our longer term target of 17%.

Before I wrap up, I wanted to address the recent announcement about further optimization of our supply chain. We are making significant investments to continue the transformation of our manufacturing and distribution network to maintain our competitive advantage, while also selectively rationalizing less efficient or redundant areas to lower costs.

We are investing approximately \$230 million through fiscal 2026 in various facilities to modernize our supply chain, including added capacity and capabilities. These projects will create approximately 210 new roles, especially with new aseptic technology opportunities in Maxton, North Carolina. This is in addition to the previously announced \$160 million investment in our Richmond, Utah site to expand Goldfish capacity.

We are also closing our Tualatin plant as we shift soup and broth production to more advantaged sites, while also simplifying our Jeffersonville, Indiana plant to focus on Late July tortilla chip production and move potato chip production to more scaled locations. The impact of these changes will be the reduction of 415 roles and be executed over the next two years.

We continue to evaluate additional optimization opportunities across the network to build our supply chain of the future. At our upcoming Investor Day, we plan to provide full program details and savings to lay out the next source of fuel for growth and earnings.

In summary, the third quarter was a solid quarter where we advanced in every aspect of the business. We saw stabilizing trends on growth and volumes, compelling earnings with margin improvement, and a great start to the integration of Sovos Brands.

As we continue to control the controllables in a dynamic environment, I remain confident in our outlook and continue to see this moment as a tremendous time for the company to begin its next chapter of sustained growth. I'm looking forward to laying out that path fully for you at our upcoming Investor Day in September in New York City.

With that, let me turn it over to Carrie.

Carrie L. Anderson

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

Thanks, Mark, and good morning, everyone. I'll start by sharing some highlights from our third quarter. We had a lot of positives, including the better-than-expected contribution of the Sovos Brands business to our performance. Reported net sales were up 6%, driven by the partial quarter of sales contribution from Sovos Brands.

Organic net sales, excluding the impact of acquisitions, divestitures, and currency, were comparable to the prior year and continued to show sequential volume improvement. On a two-year compounded annual growth rate basis, organic net sales grew 2%. Both adjusted EBIT and adjusted earnings per share increased double digits in the quarter with expansion in both adjusted gross margin and adjusted EBIT margin.

Adjusted EBIT increased 13%, primarily driven by the contribution of Sovos Brands as well as higher adjusted earnings in the base business. Adjusted EPS increased 10% to \$0.75 with the impact of the acquisition approximately neutral in the quarter, exceeding our initial expectations.

Slide 24 shows that organic net sales were stable with nominal impacts from net price realization and volume and mix. We experienced sequential improvement in the third quarter and expect these volume trends to modestly improve in Q4. And during the quarter, Sovos Brands added 7 percentage points to reported net sales growth, which exceeded our expectations.

On slide 25, third quarter adjusted gross profit margin expanded 30 basis points compared to the prior year to 31.2%. The drivers of margin expansion included supply chain productivity, cost savings initiatives, and favorable volume and mix. These contributors more than offset cost inflation and other supply chain costs and the impact of the Sovos acquisition, which has a lower margin profile than the base business.

Core inflation in the quarter remained in the low-single-digit range, consistent with rates we experienced in the first half and much lower than the 8% reported in the prior year. We anticipate core inflation to remain in this range for the balance of fiscal 2024, and we will stay focused in areas of our portfolio with increased input cost, such as tomatoes, olive oil, cocoa, and other areas of persistent inflation, such as labor costs and warehousing costs.

Through the end of the third quarter, we achieved \$940 million of our \$1 billion multi-year cost savings program. Similar to Q3, we expect our productivity initiatives and cost savings programs to offset the impact of inflation in the fourth quarter.

Turning to slide 26, other operating items include adjusted marketing and selling expenses, which increased 2% to \$198 million. The increase was primarily due to the impact of the recent acquisition, partially offset by lower costs in the base business, including lower advertising and consumer promotion expense, lower incentive compensation expense, and lower selling expense.

Adjusted administrative expenses increased \$2 million or 1% to \$156 million due primarily to the addition of the recent acquisition. Adjusted administrative expenses benefited from approximately \$3 million in cost synergy realization from our acquisition integration plan that I will touch on a bit more when covering our next slide.

As shown on slide 27, third quarter adjusted EBIT increased 13% and adjusted EBIT margin increased 90 basis points, primarily due to higher adjusted gross profit from the contribution of the acquisition and the base business. This was partially offset by higher adjusted expenses, including marketing and selling, administrative, research and development, and other expenses, primarily due to the addition of Sovos Brands expense in these P&L categories.

As mentioned earlier, these higher adjusted admin expenses were partially offset by approximately \$3 million in cost synergies related to our Sovos Brands integration plan. We expect to realize a total of \$50 million in annualized cost synergies by the end of the second year post close, of which about two-thirds are expected in the administrative expense area and the balance in cost of products sold.

As Mark indicated, we are pleased with the pace of the integration and look forward to sharing more about the next phase of our cost savings initiatives at our Investor Day in mid-September, which will encompass Sovos synergy savings as well as incremental supply chain network savings.

On slide 28, adjusted EPS increased double digit to \$0.75, primarily reflecting higher adjusted EBIT and a lower adjusted effective tax rate, partially offset by higher adjusted net interest expense related to higher levels of debt to fund the acquisition. As we mentioned earlier, the acquisition was approximately neutral to adjusted EPS.

In Meals & Beverages, third quarter reported net sales increased 15% due to the partial quarter contribution of the Sovos Brands acquisition. Pro forma third quarter net sales growth for the division, as if the acquisition had occurred at the beginning of the third quarter of fiscal 2023, was approximately 5%, driven by the respective pro forma Q3 growth of Sovos Brands of approximately 27%. This Q3 pro forma Sovos growth benefited from the timing of Rao's sauce inventory builds and a shift in the timing of a promotion in non-measured channels.

Organic net sales for Meals & Beverages, excluding the acquisition, were flat with the favorable impact of volume and mix offset by net price realization. In the quarter, gains in our foodservice business were offset by lower sales in US retail where we saw declines in beverages, Campbell's pasta and Swanson canned poultry, partially offset by gains in Prego pasta sauce and US soup.

In US soup, sales increased 2%, an encouraging indicator in the business and supportive of the expected sequential improvement in the second half of fiscal 2024. A 2% sales increase was primarily due to an increase in broth sales, partially offset by lower sales of ready-to-serve and condensed soups.

In addition, we were pleased with the third quarter Meals & Beverages operating margin of 18%, which improved 160 basis points year-over-year, more than absorbing the impact of the recent acquisition, which, as I mentioned earlier, has a lower margin profile than the base business.

Third quarter organic net sales in Snacks were slightly lower by 1%, but we were encouraged by the continued sequential improvement of the year-over-year volume trends from the second quarter. The lower sales were primarily driven by declines in third-party partner brands, contract manufacturing, and bakery, partially offset by a 2% increase in our Snacks power brands.

On a two-year compounded annual basis, Snacks organic net sales and power brands net sales increased 6% and 9%, respectively. Net price realization was neutral in the quarter. Third quarter operating margin for Snacks was 15.2%. This was a lower margin compared to last year, but came in as expected due to lapping a tougher comparison with last year's Q3 margin benefiting from the combination of pricing waves and the timing of fiscal 2023 marketing and selling expenses.

Year-to-date margins of 14.9% have improved 40 basis points from the prior year and are approaching our 15% goal for the full year fiscal 2024. We intend to share more details related to our longer-term roadmap for a Snacks margin of 17% during our Investor Day.

Turning to slide 31, we continue to generate strong cash flow from operations of nearly \$900 million through the end of the third quarter. This result was slightly lower than prior year, primarily due to cost related to the acquisition. Year-to-date capital expenditures were \$376 million, up from \$257 million in the prior year as we continue to prioritize key growth and capability building investments.

We also remain committed to returning cash to our shareholders with \$334 million of dividends paid and \$46 million in anti-dilutive share repurchases year-to-date.

With the closing of the Sovos Brands acquisition in the quarter, our net debt to adjusted EBITDA leverage at the end of the third quarter was 3.9 times as expected. We remain committed to investment-grade ratings and our goal to return to our 3 times net leverage target by the end of year three post-close.

At the end of the third quarter, we had approximately \$107 million in cash and cash equivalents and approximately \$1.85 billion available under our revolving credit facility, which we renewed this quarter. We are updating our fiscal 2024 full year guidance to reflect the expected performance of the base business and the impact of the recent acquisition.

Full year reported net sales are expected to increase approximately 3% to 4%, driven by the partial year of net sales contribution of Sovos Brands. Full year organic net sales growth is currently pacing to the midpoint of our updated range of approximately flat to down 1%, reflecting the current pace of consumer recovery. At the midpoint, this represents about a 0.5 point lower than what we indicated on our second quarter earnings call when we said we expected organic net sales to be at the low end of flat to 2%.

As Mark mentioned, and like other companies in the food industry, we continue to be impacted by a dynamic macroeconomic environment and observing a discerning consumer that is particularly impacted at lower income levels.

At the midpoint of our updated net sales guidance, implied fourth quarter organic net sales growth is expected to moderately increase sequentially from Q3, and we expect a low-teens pro forma net sales contribution from Sovos Brands in Q4, reflecting the timing shifts from Q3 that I mentioned earlier.

We feel really good about the performance of Sovos Brands, specifically Rao's, with sales growing faster than our expectations at the time of the deal announcement, thus enabling us to benefit from a higher level of adjusted EBIT contributions since closing.

Moving forward, we still expect long-term Sovos Brands net sales growth to be in the mid-single-digit range. We'll provide more specifics on near-term fiscal 2025 expectations on our fourth quarter earnings call.

Full year adjusted EBIT growth for the combined business is expected to be approximately 6.5% to 7%, reflecting the partial year contribution of the acquisition, inclusive of integration savings, and base business performance, including lower adjusted marketing and selling expenses, and favorable net price realization, productivity, and cost savings, more than offsetting inflation and other supply chain costs.

This outlook implies fourth quarter double-digit adjusted EBIT growth driven by the contribution of the acquisition and the performance in the base business, including improving adjusted gross margin as well as lapping a 23% increase in A&C in the prior year.

As a reminder, the adjusted EBIT contribution of Sovos in our results includes stock-based compensation expense and acquisition-related depreciation and amortization expense, whereas historically when Sovos was a stand-alone company, these costs were not included in their adjusted results.

Annual transaction-related depreciation and amortization expense is expected to be in the range of \$15 million to \$20 million, in line with our original expectations. Full year adjusted EPS for the combined business is expected to be up approximately 2% to 3% in a range of \$3.07 to \$3.10. This includes expected dilution from the Sovos acquisition between \$0.01 to \$0.02 per share for fiscal 2024. This full year outlook also implies double-digit growth in Q4 adjusted EPS, driven by expected higher adjusted EBIT, partially offset by higher net interest expense related to the acquisition.

And then a few other guidance items that I'll update. Full year cost savings towards our \$1 billion enterprise-wide program are expected to be in the range of \$55 million to \$60 million. Full year adjusted net interest expense is now expected to be approximately \$245 million versus our prior forecast of \$185 million to \$190 million, reflecting incremental interest expense associated with the new acquisition-related debt. And full year capital expenditures are expected to be approximately \$500 million as we continue to invest in our business for the long run. All other underlying guidance assumptions remain unchanged.

To wrap up, we were pleased with our third quarter results, delivering double-digit growth in both adjusted EBIT and EPS and margin expansion, as well as better-than-expected acquisition performance. As we head into Q4, we remain encouraged by the continued expectation for improving volume trends in the business, another quarter of double-digit adjusted EBIT and earnings per share growth, and building on the great start to the integration of the Sovos Brands business.

With that, let me turn it over to the operator to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Andrew Lazar from Barclays. Your line is open.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Q

Great. Thank you. Good morning, Mark and Carrie.

Mark A. Clouse

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

A

Hey, Andrew.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Q

Hey there. Mark, maybe to start off, I guess, what gives you the confidence in a full recovery in your fiscal first half of 2025 while kind of simultaneously taking down your 2024 organic sales forecast by about 50 basis points? And I guess, when you say full recovery, how do you sort of define that? Thank you.

Mark A. Clouse

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

A

Yeah. That's a good question. So, I think one of the things – maybe just set a little bit of context, I think one of the things that has made this predicting consumer recovery a little more challenging than it probably seems that it should be is the nonlinear kind of path that it's followed where, depending on income level of consumer and category that you're referencing, the pace of impact has been somewhat staggered. And I gave the example this morning, which I think is a big reason for the moderation [ph] on inorganic (00:33:08) outlook for the balance of the year, which is that the Snacks business in many ways, and not inconsistent with history, tends to be very resilient. And I think a combination of the role that snacking plays, a little bit of the emotional connection in tough times, all of those elements have kind of made Snacks a bit more resilient.

But as we started the third quarter, we began to see what I would describe as kind of a catching up, if you will, of some consumer trade down, a little bit more buying on promotion, things that we had seen on the Meals & Beverage categories almost a year ago. And so, as you look at Meals & Beverage, and especially as we watch these next four weeks – or the last four weeks, you see kind of a full cycling of that consumer change in behavior on Meals & Beverage, and thus you're seeing Meals & Beverages, to a certain degree, recover. And when I say recover, it's not a hockey stick of change to positive, but more of a neutral base that then the categories kind of return, I would say, more to a historical run rate.

And so, in the last four weeks, as an example, if you were to come all the Meals & Beverage categories, on a dollar basis, we're up about 1%, and on units, we're about up the same. So, you're seeing both units and dollars normalized to positive, but fair to say Meals & Beverage kind of felt the impact a lot earlier. So, why we say the first half, and again, that's a pretty broad six-month window, I think I'm trying not to create a false sense of accuracy of pinpointing it, but I do think through the first half of the year, Snacks will have cycled a fair amount of what I would say their consumer adjustment or change in behavior is.

Now, a little bit of the underlying element in all of this that's important is still how well are we executing? What does the promotional landscape look like? How are we doing with innovation, all the other variables? And I do feel really good about that outlook in 2025. And so, I think the combination of those, albeit about six months later than we would have liked it to be, but I think then as you cycle through that kind of full swing, that puts you in a position where to see it in the first half of next year.

Now, one thing that I will say is encouraging, and this was always a little bit of a question mark and a bit more real-time data, as we go into the summer, obviously the holiday weekends and kind of the summer barbecue and entertainment is such a key moment for snacking, what is a little bit more encouraging is you're seeing the Snacks categories in the latest four weeks, although not back to fully positive, pretty close to neutral, down about a 0.25 point, units are off about a 0.5 point, but that's significantly better than what we were seeing in Q3.

And even more interesting, I think, is some of the categories that index a little bit more to the upper end of middle income to higher income are actually performing really well in the latest four weeks. Things like Kettle potato chips, tortilla chips, some of our specialty like Pretzel Crisps, these categories are all growing in the latest four weeks kind of mid-single digits, which, again, the recovery path is not necessarily linear.

Unfortunately, for the middle and lower middle and lower income, they feel it a little bit more, and I think the durations weighed a bit heavier. So, that may be a little more than you bargained for, Andrew, on why we're pinpointing this, but it is complicated, and I think trying to help people understand why it's not so simple to just put a pin in the ground on [ph] when (00:37:24) it's going to turn by every category is probably important to understand.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Q

Yeah. No, I appreciate the context. Thanks very much. I'll pass it on.

Operator: Your next question comes from the line of Jim Salera from Stephens. Your line is open.

Jim Salera

Analyst, Stephens, Inc.

Q

Hi, guys. Good morning. Thanks for taking our question.

Mark A. Clouse

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

A

Hey, Jim.

Jim Salera

Analyst, Stephens, Inc.

Q

Mark, I wanted to maybe size up the longer-term opportunity for Rao's given the strength and the performance that the sauce has seen. Can you just give us some thoughts around what do you think the upside is on the sauce side and then maybe speak to some of the other growth avenues, like frozen pizza, frozen meals, ready-to-serve soup, and as we integrate Rao's into our models, how we should think about that as a growth engine moving forward?

Mark A. Clouse

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

A

Yeah. Obviously, there's a lot of good detail in that question, and I will say that I think part of the advantage of doing our Investor Day in September is it will give us a chance to really have that wired pretty tight and arguably be able to give you a little more depth on it. But here's what I'll say so far. I could not be more happy with how the Rao's integration is going. And really, I have to say, it's on almost every variable within how you would assess an acquisition for a company. And again, I'm not entirely surprised. We were very patient and I think a lot of great diligence, but almost to the point, we have validated all of our assumptions, if not identified upside, to just about everything that we laid out for you at the time of the announcement.

So, whether you're looking at the deal economics, all of those are more positive today than they were, great job executing the deal financials really across the board. The health of the business, if you remember, I mentioned this in my comments, but we laid out a list of reasons to believe why growth on Rao's would continue, and really, to the item, we're pacing ahead of what we would have expected those to look like. And again, just another really incredible testament to the team, which is another point, I really, again, applaud the work that Todd and team had done in assembling an organization and a group of folks that really know this business and how to drive it.

And I could not be more happy about the number of Sovos employees that have joined Campbell's, starting with Risa, who's leading our efforts, including our Pacific business, and doing just an amazing job. So, I mean, honestly, as I tick down the list, I just would say everything so far really feels good. Now, I do recognize it's early and there are some things in your question that I want to spend a little more time on understanding, like the role of frozen. We did not depend on that heavily in our growth model, but I will say when I look at the performance of frozen pizza as an example, it is really encouraging. And if I think about other adjacencies like soup and dry pasta, both of which are doing very, very well.

And as I said on the call today, I think perhaps one of the most pleasant surprises to be is really the strength of the noosa business. And although we had a fairly clear understanding that yogurt was probably not a long-term strategic category for us, the strength of that business, the uniqueness and even the performance of it, again, a testament to a really great team that's leading it and doing a terrific job of running it.

So, when I think about it, I don't think we're willing to – and by the way, also on synergy, I think really clear line of sight to the \$50 million, arguably, the path to achieving that may be a little bit faster, which will certainly help in the accretion and dilution, although I do expect still to be some dilution as we look at 2025. But I think the net of all of it is a really encouraging start, significant and comprehensive validation of our assumptions. And I think in September, we'll try to give you a little bit more detail in unpacking each of the pieces. So, hopefully, that helps get you started with a little bit more to come as we get together in September.

Jim Salera

Analyst, Stephens, Inc.

Q

Yeah. That's great. Appreciate the color. I'll hop back in the queue.

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

David Palmer

Analyst, Evercore ISI

Q

Thanks. Good morning. Interesting to hear your comments about the low-income consumer and the pullback in Snacks. It kind of reminds me of what's happening in fast food. And in both segments, I would imagine that key

players are keen not to lose the upcoming key summer selling season. You talked about that. I just wonder, I guess the question is, what should we expect from price/mix from that segment over the next one or two quarters as you probably face that type of environment? Thanks.

Mark A. Clouse

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

A

Yeah, I think that we've talked about this a little bit before, that from a historical perspective, well before COVID, the Snacks categories in general tend to be a bit more promotable. I think it's a function a bit of the impulse nature of the categories and the competitive nature of the categories. I do think what you should expect to see from us is continuing to remain competitive. Now, I do think given our categories and brands, we're not going to win this fight on the longer term by taking price down dramatically or going to promoted levels that are not sustainable. That's not going to be the right playbook for more elevated brands.

I think a great example of that is right now in cookies, which is a tough category, where we are seeing a fair amount of trading down into private label. The good news is our Pepperidge Farm business is really kind of holding its own, not by dealing the price points, but by continuing to bring added value. And so, kind of in the mindset of, if I'm being a little more thoughtful with my Snack dollars, let's make it really count, it's been more of the strategy on our more premium cookie business, which is proving to kind of be holding our own in that category, which has been probably one of the more difficult.

I think as you get into salty, what we're going to want to do there is make sure that we've got reasonable price gaps, that we are at the key windows and on display at those key moments, while continuing to bring a really robust level of innovation and news on our brands. And I think, in particular, one of the places we're seeing a lot of competition is in Kettle potato chips, which has been an extremely successful segment and continues to be, but we're also seeing a lot more competition there. And so, we're going to want to make sure that we get the balance right.

So, what does that actually mean? I think in the fourth quarter, you'll see a little bit of balance between promo and investment in marketing. The net of it, I think, will be a pretty healthy investment, nothing that is out of the realm of history relative to promotion, but certainly we want to stay nimble and make sure that we're as competitive as possible. And so, would you see 100 basis points or so of investment in promo as we think about Q4? I think that's probably a generally good proxy as we kind of navigate these next couple of quarters.

David Palmer

Analyst, Evercore ISI

Q

No, that's helpful. Thank you. And on Meals & Beverages, just a quick one there. Just the pricing down 1%, we were a little surprised to see that. Why did that happen and what's your outlook for pricing in that segment going forward?

Mark A. Clouse

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

A

Yeah. I think part of – interestingly enough, as I said earlier, this kind of staggered approach to consumer behavior, I think we're a lot further down the road as it relates to the Meals & Beverage categories, which arguably we're experiencing a little bit of a trade-down pressure and some of the competitive dynamics that we're seeing now in Snacks we were dealing with a year ago. And what we've been doing is really making sure that we've got the right framework in place relative to price gaps. I'll give you a great example of getting that balance right.

When you think about our condensed soup business, that's one of the areas where we've tended to really see a lot of competitive pressure, and that's probably where private label has been a bit more relevant as we've looked at trade-down and where we've experienced. So over the course of the last six months or so, we've really been fine-tuning what that price gap needs to be, while continuing to support some innovation and marketing on the business. And in the third quarter, we were able to kind of re-stabilize, if you will, the share position, but the category was still down about 4%.

As you go into the latest four weeks, and recognizing we are coming into the summer, where the magnitude of the numbers are certainly smaller, but you're now seeing even an acceleration or step up, if you will, in the soup business, and accelerating both top line, which is now positive on the condensed business, as well as share and units looking better, while private label has taken a bit of a step back in that category.

So, I think in many ways that may have been a little bit more muted pricing that was recognized as probably not the right thing to do for the category. This is not a significant deal down. You know that, because you're also seeing very material gross margin [ph] in Meals & Beverages and (00:48:36) time. I know that in the consensus, we're a little lower than what some people had modeled, but please remember that the mix impact of Sovos into that number is diluting that, about 30 basis points in the quarter. If you were to add that, you'd be a lot closer to, I think, where people's expectations were.

So, generally speaking, I feel very good about the profit trajectory for Meals & Beverage, but I also think we've got that playbook pretty well refined, and you see it in soup as the recovery really continues to build momentum and actually moving into positive territory both on units and on dollars, which is really important.

David Palmer

Analyst, Evercore ISI

Q

That's helpful. Thank you.

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

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Hey, Mark, Carrie. Good morning.

Mark A. Clouse

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

A

Hi, Peter.

Peter T. Galbo

Analyst, BofA Securities, Inc.

A

Mark, maybe if I could – hey. Maybe if I could just pick up on the last point you had there on the trajectory of gross margin. I mean, I think the revised guidance implies a meaningful ramp into the fourth quarter, both sequentially and year-over-year, relative certainly to where the quarter came in. So, maybe you can just unpack what's driving the acceleration or reacceleration on the gross margin line as we get into 4Q and then start to think about 2025.

Mark A. Clouse

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

A

Yeah. Why don't I – I'll give a little bit of broader context and let Carrie do a little bit of the bridge or the [ph] due to (00:50:07). But you're absolutely right, it is important to remember that fourth quarter a year ago, we're cycling a pretty tough quarter from a year ago, where we were feeling a lot of the kind of cumulative impact in absorption in some of our facilities given the volume reduction that we'd experienced through that cycle of pricing. If you remember, we talked a lot about this other supply chain cost line, which was a combination of some inflation, but also what I would describe as some of the inefficiency that we were navigating on the business.

And so, when you take that away and you start to stack on top of it the productivity that we have at the same time, as well as one of the linchpins to the quarter was the recovery or improvement in the soup trajectory, which gives us an underlying tailwind on mix, which also was depressed in the fourth quarter, along with the Snacks roadmap and all of the other variables that we have attributing, we are expecting a significant step up in EBIT and in margin.

Again, a very healthy gross margin expansion, but where I talked a little bit about the dilution associated with Sovos, you'll see that more to the tune of about 40 basis points on the company. It's about 80 bps or so, again, not a problem, not inconsistent with what we expect, but generally will depress a little bit of the upside. Still significant upside even with that, but at the end of the day, a little bit more modest than what might be in a few models.

But the net of all of that is you're going to be looking at EBIT growth that is probably in the 30s for percent growth, very, very strong EPS growth, and margin expansion really across the board. So, a very good quarter of sustained sequential recovery, which has really been – albeit maybe a little bit behind the pace of recovery that we wanted in the total business, the march forward has been very consistent and methodical, and fourth quarter will continue that.

I don't know. I may have covered all of it here. Carrie, did I cover it all? I'm sorry.

Carrie L. Anderson

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

A

You covered it perfectly.

Mark A. Clouse

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

A

I'm sorry. Yeah, that's a...

Carrie L. Anderson

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

A

It's a lot like Q3 in terms of the drivers of that expected expansion.

Mark A. Clouse

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

A

Yeah, I think with the notable exception that Snacks, as we noted in the Q2, had a very, very good Q3. That's why you see a little bit of pressure in Q3. I would expect to see them return to growth...

Carrie L. Anderson

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

A

Yeah.

Mark A. Clouse

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

A

...in the fourth quarter.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Got it. Okay. That's super helpful. And then, Mark, maybe just a quick one on Meals & Bevs, I think you called out in the press release foodservice actually as a source of upside. That would seem to kind of buck the trend relative to what we're hearing from...

Mark A. Clouse

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

A

Yeah.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

...a lot of other folks. So, maybe you can just touch on that a bit.

Mark A. Clouse

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

A

Yeah, I think the big enabler for us on the foodservice kind of divergence, if you will, from many of our peers has been the benefit of the supply chain progress we've had. As a reminder, our foodservice business, which sits in our Meals & Beverage division, is actually made up of both Meals & Beverage and Snacks businesses. And one of the things that we're seeing a lot of growth on right now is the expansion in capacity that we've been adding on snacking and enabling our foodservice teams to be able to sell with confidence against those brands. So, that's gone very well.

And then I also think, again, interesting when we think about the world of soup and we look for positive signs or positive indicators of stabilization of this category and the role it can play, one of the areas we're seeing an uptick in demand is our frozen soup business in foodservice. So, more selling of soup as a menu item has been a pleasant surprise. And that, I think, continues to be – those two drivers, our soup business and our Snack business, are really the two drivers for why, I think, you're seeing a little bit of a disconnect, if you will, in the growth of our foodservice business versus what you're seeing more macro trend-wise in that particular industry.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Great. Thanks very much, guys.

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

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Yeah, thank you. Good morning, everyone.

Mark A. Clouse

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

A

Hey, Nik.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Just two quick ones for me. Hey, Mark. Just on Snack, it was obviously – it's been something that's been called out as a potential tailwind as we kind of roll through the year. So, just wanted to get any perspectives from your side on if you're seeing any benefits of that. But the broader question, I guess, is just kind of pricing has been a key theme for this Q&A. Mark, do you worry about kind of price thresholds right now? I mean, it seems like just given the amount of inflation, consumers are just feeling the burden. And I just wonder if like we've kind of gone too far. And I know rollbacks are not part of the historical strategy here for the entire CPG industry, but just we seem to be in a very anomalous situation right now, so I just would love your thoughts around that.

Mark A. Clouse

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

A

Yeah. No, I know that is a significant topic of discussion right now, which is, were we seeing an overpricing on an absolute basis. When I look at the data today, I'm not yet seeing that as a significant concern, other than as it relates to the context of where price gaps may be sitting. One data point that hopefully will make everyone feel a little bit better, if you look at the last four weeks through Memorial Day, salty as a broader category was essentially flat. And that's not a good thing, right, given the historical growth that we've seen. But relative to what we had been seeing in the third quarter as a more material slowdown in that segment was a little bit better.

Now, arguably, that's a fairly promoted period around Memorial Day. And so, I think you'll see that drumbeat of promotion fairly consistent. But I'm not yet concluding that any of our – I can't speak to the industry broadly, but from our standpoint, I wouldn't yet say that there's a place where we priced too far. I do think there are some places where we have to [ph] mind (00:57:26) the price gap perhaps a little bit better, a little bit tighter, maybe a little bit more frequency, but not necessarily a more dramatic step down in depth.

So, I think we need to watch that, and this is why I think these next few months through the summer and into the fall will be quite important for us to kind of do a little bit what we've done on Meals & Beverage, which is settle in to where we think the right price architecture looks like, the right promotion strategy, and make sure that we've got that balance right. But I'm not yet seeing a compelling call to action to necessarily lower pricing. But as I said, I do think you'll see a pretty good drumbeat of promotion, not wild price points, but a fairly drum – a good drumbeat of promotion in the fourth quarter.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Great. And then just on the Snack perspective?

Mark A. Clouse

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

A

Yeah. Look, I think Snacks – again, I am not – as we dug into this information more, I look at this and I go, you got a three-year CAGR of 8% if you take the third quarter on a three-year basis, which third quarter was our toughest underlying trend. I mean, the latest four weeks look better actually, as I said before. When you think about it in that context, a lot of discussion around is there structural changes in the demand or the role of snacking? I just don't see it. Do I see some normalization and some catching up a little bit of wearing down economically of

consumers? I do agree, and I think that is the primary driver. But I don't think, in my mind, I see anything that indicates to me that we don't still have a great runway ahead.

Now, what I will say is I do think our portfolio is a bit better positioned, because if you look at where the fight is really happening in snacking with private label, and there's no question that private label has made some headway into snacking, but a lot of that is happening, as you would expect, in the mainstream segments. And so, the fact that our portfolio indexes much more to elevated categories, I actually like the setup for the future. Even in a world where private label may play a bit more of a role in Snacks, we tend to be in that elevated level above. And even as I mentioned in the latest four weeks, those segments, you're actually seeing a little bit more recovery.

It's early, and I don't want to overcast the Memorial Day performance as a trend line, but I do think it's all encouraging and supports what we have believed, which is that the future of snacking and where the growth is really going to come from is more of these added value segments. And that bodes very well for how our portfolio is set up versus some of our competitors.

Nik Modi

Analyst, RBC Capital Markets LLC



Great. Thanks. Pass it on.

Operator: And we have reached the end of our question-and-answer session. Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. 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 2024 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.