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CPB - Q3 2017 Campbell Soup Co Earnings Call

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OVERVIEW:

Co. reported 3Q17 as-reported net sales of $1.853b and adjusted EPS of $0.59. Expects FY17 sales to change by minus 1% to 0%.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Campbell Soup Third Quarter 2017 Earnings Call. (Operator Instructions) As a reminder, today's conference call is being recorded.

I would now like to turn the conference over to Ken Gosnell, Vice President of Investor Relations. Please go ahead.

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

Thank you, Candace. Good morning, everyone. Welcome to the Third Quarter Earnings Call for Campbell Soup's Fiscal 2017. With me here in New Jersey are Denise Morrison, President and CEO; and Anthony DiSilvestro, CFO.

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 listen-only mode.

Today, we'll make forward-looking statements which reflect our current expectations. These statements rely on assumptions and estimates, which could be inaccurate and are subject to risks. 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.

One additional item before we begin our discussion of the quarter. I'd like to cordially invite our sell-side analysts and institutional investors to our annual Investor Day at Campbell's World Headquarters. RSVPs are required. All others are invited to join by webcast. This year's event will be held in the afternoon of Wednesday, July 19. We will include updates on our plans and key initiatives for the 3 operating divisions. We'll also have time for interacting with our management team, so I hope everyone can make it.

With that, let me turn it over to Denise.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Thank you, Ken. Good morning, everyone, and welcome to our third quarter earnings call. Today, I'll share my perspective on our performance this quarter and outline our expectations for the remainder of the fiscal year.

First, some context on the macroeconomic environment. Overall macroeconomic trends in the U.S. improved slightly in the quarter. Consumer confidence edged up, and unemployment declined modestly. However, in the first quarter of the calendar year, consumer spending only grew 0.3%, its lowest level of growth since 2009. Consumers entered 2017 facing a variety of interrelated pressures and complexities from economic shifts, delayed tax refunds and general uncertainty. Many consumers continue to struggle financially, especially lower income and younger shoppers.

Additionally, the retailer environment continues to be very aggressive, with e-commerce and value players applying increased pressure on grocery and mass channels. And we do not anticipate this trend to abate anytime soon.

Food companies certainly felt the pinch. It was a challenging quarter across the industry as top line growth remains scarce, especially in center-store categories. Consumers continue to migrate to fresher and healthier foods found on the perimeter of food stores. Like the majority of our peers, early in the calendar year, we experienced significantly lower consumption across almost all of our categories. At Campbell, we felt it most acutely in February. While trends improved as the quarter progressed, growth in March and April was insufficient to offset the earlier weakness.

In the context of this unfavorable operating environment, we delivered competitive results in the third quarter. Although our top line was below our expectations, we grew or maintained market share in 11 measured categories, representing 75% of our U.S. retail dollar sales.

Looking at Campbell's results. Organic sales declined 1%, adjusted EBIT declined 2% and adjusted earnings per share declined 9% to $0.59 a share, primarily due to a higher adjusted tax rate. The sales decline in the third quarter resulted from softer-than-expected soup sales, the ongoing capacity-related challenges in Campbell Fresh refrigerated beverages and weakness in V8 beverages. This more than offset the strong results from Global Biscuits and Snacks in the quarter.

Let's look at our 9-month results. Year-to-date, organic sales were down 1%, adjusted EBIT was comparable to a year ago and our adjusted EPS was up 1%.

Reflecting our performance in the quarter, we revised our fiscal 2017 guidance this morning. We lowered our sales guidance to minus 1% to 0%, a point below our previous expectations. Despite the challenges on the top line, we raised the low end of our adjusted EBIT and adjusted EPS ranges. We now expect adjusted EBIT to increase 2% to 4% and adjusted EPS to increase 3% to 5%. We expect that we'll be able to offset the impact of lower sales with our ongoing cost-saving efforts, which are ahead of our expectations for the fiscal year.

Now let me share my thoughts on our segment performance for the quarter and offer some perspective on our plans for the balance of the year. Let's start with our largest division, Americas Simple Meals and Beverages. We continue to manage this division for performance consistent with the categories in which we operate and for margin expansion. Organic sales declined by 2% in the quarter, predominantly driven by U.S. Soup and V8 beverages. Operating earnings were comparable to a year ago.

Importantly, we continue to expand gross margin in the division, even as we made investments in real food. As we've previously outlined, we're in the process of eliminating artificial colors and flavors from our products, removing BPA from the can liners in our soup portfolio and increasing the use of real food ingredients, such as chicken with no antibiotics in our soups.

Despite gaining share in the quarter, soup sales declined 4%. Year-to-date, soup sales declined 1%. Although soup performance improved throughout the quarter, we were unable to overcome the slow start in February. Sales of condensed soup and broth declined, while our ready-to-serve portfolio grew. Promotional activities in support of condensed soup did not generate the anticipated lifts, while the decline in broth was the result of continued competitive activity from private label.

On the plus side, sales growth in our ready-to-serve portfolio was fueled by Chunky and our new Well Yes! soup line. Chunky benefited from increased merchandising, improved marketing and new items. We remain enthusiastic about the launch of our new Well Yes! clean-label soup. Customer response has been strong, and consumer trial is ahead of expectations. In the fourth quarter, we're planning to expand the Well Yes! line with 5 new varieties and to introduce a significant line extension to Chunky, new Chunky Maxx Bowls featuring 40% more protein.

Given our performance year-to-date and with the season being largely complete, we're now calling for soup sales to be down slightly for the year, even while we gained market share.

Beyond soup, Prego continues to perform well, driven by strong consumption, increased distribution in club channels and contributions from Prego's Farmers' Market.

V8 beverages continue to struggle as the shelf-stable juice category remains challenged. As discussed last quarter, 2/3 of our shelf-stable juice portfolio, V8 100% Vegetable Juice, Veggie Blends and V8 +Energy is on trend and leverages our heritage in vegetable nutrition. The remaining 1/3 of the portfolio, consisting of V8 V-Fusion and V8 Splash, is under pressure due in part to category-wide consumer concerns about sugar.

In the quarter, sales of both Fusion and Splash declined, while V8 100% vegetable juice grew behind continued media investments. V8 +Energy also grew as we expanded distribution of new carbonated varieties.

Year-to-date, the Americas Simple Meals and Beverage division is performing in line with its portfolio role. While organic sales have declined 1%, operating earnings have increased 5%.

Moving on to Campbell Fresh. C-Fresh remains an important strategic business for Campbell's, and we're confident in the growth potential of the Packaged Fresh category as consumer preferences for fresher and healthier foods remain strong. C-Fresh sales declined 6% in the quarter, primarily driven by continued production constraints following the June 2016 voluntary recall of Protein PLUS beverages. As discussed during our last call, we've implemented enhanced processes to improve quality standards. We also started up a new beverage line in Bakersfield in the quarter and are in the midst of qualifying a new co-packer, which is slated to come online late in the fourth quarter.

As expected, we still haven't returned to our original production levels. We've been able to fill orders for shelf stock. However, we have been unable to execute normal promotional activity across the fresh beverage portfolio. We expect continued capacity constraints through the fourth quarter as we fully operationalize our new line and our co-packer starts production. We'll begin increasing promotion activity towards the end of the fiscal fourth quarter and expect to ramp up to normal levels in the first quarter of fiscal 2018.

On the innovation front, the reception of our new Bolthouse Farms products, including the new plant-based protein milk, has been positive by retailers. We'll start shipping this exciting new product early next fiscal year.

Turning to our farms business. Sales declined slightly driven by the natural ingredients business. We've made good progress stabilizing our carrot business, which delivered modest sales growth in the quarter as our quality and customer service levels have improved.

Overall, we're moving in the right direction under our new leadership team. We've leveraged this tough situation this year to build a stronger foundation for growth. Looking ahead, we anticipate that C-Fresh will deliver modest sales growth in the fourth quarter as we lap the Protein PLUS recall. While we expect the beverage business will continue to improve, we'll still be operating with less capacity than we had a year ago.

Turning now to Global Biscuits and Snacks. This division unifies our biscuits and snacks brands across Pepperidge Farm, Arnott's and Kelsen. The team delivered strong results in the quarter. Sales increased 2%, and EBIT was up 14%. The 2 main drivers of the sales increase were Pepperidge Farm and Arnott's Biscuit in Asia Pacific.

First, Pepperidge Farm. I'm pleased with the performance of the team. Pepperidge Farm snacks continued to deliver strong results, fueled by Goldfish Crackers and Pepperidge Farm Cookies. Continued Goldfish growth was driven by larger pack sizes and multipacks, increased advertising and the continued expansion of our health and well-being offerings, especially Goldfish made with organic wheat.

In cookies, sales increased across most of the portfolio. We're pleased with the April launch of our new Farmhouse cookie brand. These new thin and crispy cookies are simply delicious. They leverage our baking heritage and are made with simple, real food ingredients. It's early days, but retailer response has been positive with more than 50% ACV distribution. Consumers have also responded very favorably.

Sales declined slightly in our fresh bakery business, driven by Pepperidge Farm Sandwich and Swirl bread, coupled with increased spending to counter competitive activity. Buns and rolls delivered strong growth.

Turning to Australia. In a very challenging trading environment, we delivered sales growth in our biscuit portfolio. Our new Arnott's Tim Tam gelato-inspired varieties are performing well with strong customer acceptance and consumer takeaway. In addition, Arnott's Shapes continued to regain share with the return to several popular original flavors. We're preparing to ship, at the end of July, new multipack single-serve Arnott's Shapes, Tim Tams and Tiny Teddies in multiple sizes for take home and on-the-go consumer occasions.

In addition, our developing markets in Southeast Asia performed well with organic sales growth in both Indonesia and Malaysia. We're confident that the division will finish the year on a high note, as we expect to maintain our current momentum and deliver solid sales growth and double-digit operating earnings in the fourth quarter.

In conclusion, our team delivered competitive performance in what continued to be an extraordinarily difficult operating environment. However, we clearly have more work to do to address our sales performance.

Looking ahead to the fourth quarter, our plan calls for improved performance to finish the year as we cycle the Bolthouse Farms protein drink recall, last year's carrot quality issues and a higher adjusted tax rate. Additionally, we expect Global Biscuits and Snacks to maintain its current momentum. We also plan to return to more normal marketing levels versus the stepped-up levels of a year ago. Finally, we're on track to slightly exceed our multiyear $300 million cost savings target by the end of the fiscal, a year earlier than originally planned. And as we announced last quarter, we're pursuing incremental cost savings of $150 million over the next few years.

Thank you, and I look forward to answering your questions in a few minutes. With that, I'll turn the call over to our Chief Financial Officer, Anthony DiSilvestro.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Thanks, Denise, and good morning. Before reviewing our results, I wanted to give you my perspective on the quarter. In the context of top line challenges that impacted much of the industry early in the first calendar quarter, I feel good about our sales performance. And as Denise mentioned, we grew or maintained share in 11 measured categories, representing 75% of our U.S. retail dollar sales.

Sales for the quarter were below our expectations as declines early in the period were only partly offset by growth later in the quarter. Notably, Global Biscuits and Snacks had a strong quarter, achieving sales and double-digit earnings growth.

While adjusted gross margin declined 40 basis points in the quarter, that includes an 80 basis point negative impact from wrapping mark-to-market gains on open commodity hedges. Our promotional rate also had a negative impact on margin, exacerbated by weaker-than-expected volume performance.

We continue to make progress on our cost-savings initiatives, generating another $20 million of savings in the quarter, slightly better than expected. And we've now delivered $295 million program to date. Adjusted EPS declined 9%. But as you'll see, most of that is being driven by volatility in our tax rate.

With one quarter to go, we're revising guidance with sales coming down slightly to reflect our third quarter performance, while we tighten our earnings ranges, raising the low end by 1 point, as we remain confident in our ability to deliver our full year expectations for adjusted EBIT and adjusted EPS.

Now I'll review our results in more detail. For the third quarter, as reported net sales declined by 1% to $1,853,000,000, driven by a 1% decline in organic net sales. Organic net sales declines in Americas Simple Meals and Beverages and Campbell Fresh were partly offset by gains in Global Biscuits and Snacks.

Adjusted EBIT declined 2% to $305 million, reflecting the impact of a lower adjusted gross margin percentage and lower sales, partly offset by lower marketing and selling expenses.

Reflecting a 650 basis point increase in our adjusted tax rate, adjusted EPS decreased 9% or $0.06 to $0.59 per share. For the first 9 months, as reported and organic net sales both declined by 1% compared to the prior year. Adjusted EBIT was comparable to the prior year, and adjusted EPS of $2.51 increased by 1%.

Breaking down our sales performance for the quarter. Organic net sales declined 1%, driven primarily by increased promotional spending in Americas Simple Meals and Beverages and Global Biscuits and Snacks. In Americas Simple Meals and Beverages, promotional spending rates were up in our U.S. Soup business as we increased spending to extend the soup season and added support to Swanson broth. We also increased spending in Canada to hold certain promoted prices following our list price increase.

In Global Biscuits and Snacks, promotional spending was up in our Arnott's business as we shifted from spending from A&C to trade. Volume and mix was comparable to last year as volume gains in Global Biscuits and Snacks were offset by declines in Campbell Fresh, as we continue to be impacted by supply constraints on Bolthouse Farms beverages. And although it rounds to 0 on the chart, we did have a slightly positive impact from currency translation, principally the Australian dollar, bringing the change in our as reported sales to minus 1%.

Our adjusted gross margin percentage decreased 40 basis points in the quarter. First, cost inflation and other factors had a negative impact of 170 basis points. On a rate basis, cost inflation was about 1.5%. We are also lapping mark-to-market gains on open commodity contracts in the prior year, which accounts for 80 basis points of the decline. These negative drivers were partly offset by benefits from our cost savings initiatives. Increased promotional spending had a negative impact of 80 basis points, reflecting the drivers I previously discussed. Mix was neutral for the quarter. List price increases had a positive impact of 20 basis points, driven primarily by list price actions taken by our retail business in Canada.

Lastly, our supply chain productivity program, which is incremental to our cost savings program, contributed 190 basis points of margin improvement in the quarter.

All in, our adjusted gross margin percentage declined 40 basis points to 36.6%.

Adjusted marketing and selling expenses declined 5% in the quarter, primarily due to lower advertising and consumer promotion expenses in Arnott's as well as the benefit from our cost savings initiatives.

Adjusted administrative expenses increased 1%, reflecting higher health care costs, inflation and investments in long-term innovation, mostly offset by lower incentive compensation.

For additional perspective on our performance, this chart breaks down our adjusted EPS change between our operating performance and below-the-line items. Adjusted EPS decreased $0.06 from $0.65 in the prior year quarter to $0.59 per share in the current quarter. On a currency-neutral basis, the decline in adjusted EBIT had a $0.02 impact on adjusted EPS.

Our adjusted tax rate in the quarter increased by 650 basis points to 35% as the prior year benefited from lower taxes on foreign earnings. The increased tax rate reduced adjusted EPS by $0.06. Share repurchases reduced our share count, adding $0.01 EPS benefit. Interest expense was comparable to the prior year as the impact of lower debt levels was offset by higher rates. Currency translation also had no impact on adjusted EPS, completing the bridge to $0.59 per share.

Now turning to our segment results. In Americas Simple Meals and Beverages, organic sales fell by 2% as declines in soup and V8 beverages were partly offset by gains in Prego Pasta Sauces, SpaghettiOs pasta and Swanson Canned Poultry. Reflecting declines early in the quarter, sales of U.S. soup declined 4%, driven by declines in condensed soup and Swanson broth, partly offset by gains in ready-to-serve soups. Growth in RTS soups was driven by gains in Chunky and the launch of Well Yes!. Chunky soup performance reflects the increased merchandising, improved execution and successful new items. The launch of Well Yes! continues to progress well, with strong customer acceptance supported with our robust marketing plan. Although soup sales declined in the quarter, we gained market share in the U.S. wet soup category. On a year-to-date basis, sales of U.S. soups declined 1%.

Operating earnings in the quarter were comparable to the prior year as a higher gross margin percentage, benefiting from supply chain productivity improvement and cost savings, was offset by lower sales volume.

Here's a look at U.S. wet soup category performance and our share results as measured by IRI. For the 52-week period ending April 30, 2017, the category as a whole declined 70 basis points. Our sales performance was better than the category, declining just 20 basis points in measured channels. We had a 58.9% market share for the 52-week period with a share gain of 30 basis points. Private label grew share by 100 basis points, finishing at 13.9%. All other branded players collectively had a share of about 27%, declining 130 basis points.

In Global Biscuits and Snacks, organic sales increased 2%, driven by gains in Pepperidge Farm and Arnott's biscuits, with growth in both Australia and Indonesia. Pepperidge Farm sales increased as continuing growth in Goldfish Crackers and Pepperidge Farm Cookies was partly offset by declines in fresh bakery and frozen products. Operating earnings increased 14% to $98 million, reflecting volume growth and lower advertising and consumer promotion expenses.

In the Campbell Fresh segment, organic sales declined 6%, driven by lower sales of Bolthouse Farms beverages, which was in line with our expectations. Our Bolthouse Farms beverage business continues to be impacted by supply constraints. In the third quarter, we started up a new beverage line at our Bakersfield site. And together with the additional co-packer capacity that Denise mentioned, we expect to have sufficient capacity towards the end of the fourth quarter to support a more normal promotional schedule as we move into fiscal 2018.

Operating earnings declined by $12 million to $1 million, reflecting unfavorable sales volume and mix as well as the cost impact of reduced beverage capacity and enhanced quality processes.

Cash flow from operations was $1,011,000,000, compared to $1,211,000,000, generated in the first 9 months of last year. Cash flow in the prior year benefited from a significant reduction in working capital. Although we're below the prior year in which we generated a record level, we are on track to deliver another year of strong cash flow.

Capital expenditures declined $30 million to $195 million. Our CapEx forecast remains unchanged at $325 million for fiscal 2017.

We paid dividends totaling $314 million, up from $294 million in the prior year, reflecting our increased quarterly dividend rate to $0.35 per share. In aggregate, we repurchased $305 million of shares compared to $118 million in 2016. Current-year repurchases include $271 million under our strategic share repurchase program as we've increased our level of share repurchases. The balance were made to offset dilution from equity-based compensation.

Net debt declined by $212 million compared to year-ago levels to just over $3 billion, as cash from operations over the last 4 quarters exceeded capital expenditures, dividend and share repurchases.

Now I'll review our revised 2017 guidance. Reflecting the impact of sales performance below our expectations in the quarter, we are slightly reducing our sales guidance. We now expect sales to change by minus 1% to 0%, which is 1 percentage point below our previous range. With the impact of lower sales being offset by incremental cost savings, we are narrowing our earnings ranges. We now expect adjusted EBIT to grow by 2% to 4% compared to the previous range of 1% to 4%, and adjusted EPS to grow by 3% to 5% compared to the previous range of 2% to 5%. This guidance assumes, based on current exchange rates, that the impact from currency translation will be nominal. We continue to expect our adjusted gross margin percentage to end the year at about 38%, almost 1 point better than last year. Our EPS guidance reflects a full year effective tax rate of approximately 32%, which is unchanged, implying a fourth quarter adjusted tax rate similar to the third quarter and the favorable impact of anticipated share repurchases over the remainder of the year.

For those of you doing the fourth quarter math, the guidance implies strong earnings growth for the balance of the year. Anticipated fourth quarter earnings growth is benefiting from improved gross margin as we wrap the impact of the Bolthouse Farms recall and related production outages, and we benefit from additional cost savings, cycle marketing investments above historical levels and from the continuing earnings momentum in Global Biscuits and Snacks.

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

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

Thanks, Anthony. We will now start our Q&A session. (Operator Instructions) Okay. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Andrew Lazar of Barclays.

Andrew Lazar - *Barclays PLC, Research Division - MD and Senior Research Analyst*

Some of the companies in the packaged food space more recently have kind of been starting to walk away from some of their multiyear margin targets, I think, seeing the need to maybe spend back more to stabilize the top line and maybe get a better balance of top line and margins back. And certainly, what we're seeing from Campbell recently is a bit weaker sales like a lot of the industry, but of course, much better cost saves and margin. So I guess I'm wondering if heading into '18, is there maybe a need maybe to spend back even more than the 1/2 of the incremental cost saves that you had previously said you would, I guess, spend back through fiscal '20? Really, I guess, I'm asking, is '18, broadly speaking, do you think it's going to be a bigger reinvestment year as it will likely end up being for some of your peer companies?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. I think that the gross margin expansion that we have achieved has been done with a lot of analytic rigor and has gone after things that really are not hurting the business. And we definitely have kept our investment in advertising, consumer and trade around that 24% level, and that really hasn't changed, although the mix changes by brand depending upon the competitive situation that it's in. The -- with the $300 million we've been able to save through our effective cost savings program, we've reinvested a significant portion of that back into the business and intend to do so as we go forward in pursuit of the $150 million that we will save. When you peel it back, our top line really needs to benefit from the return to growth of Campbell Fresh, which we expect next year, and also continued progress to stabilize our V8 beverage business. Our Global Biscuits and Snacks business has momentum. Condensed is pretty stable. RTS grew nicely, and we're under some pressure in broth. So we know what we have to do to get to that growth rate.

Operator

And our next question comes from Bryan Spillane of Bank of America.

Bryan Douglass Spillane - *BofA Merrill Lynch, Research Division - MD of Equity Research*

I guess a question on C-Fresh. Year-to-date, they're -- you're basically break even in terms of profits. And I guess now you've got the new production coming on beginning in the fourth quarter and some other things you've done to sort of increase efficiencies, Anthony, can you just talk about kind of how long it takes to get back to the 5% or 6% EBIT margins you were before and kind of what the potential is above and beyond that now that you've sort of retooled that business? Eventually -- essentially just trying to understand kind of the trajectory to get back to sort of a higher level of profitability.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Right. Okay. So first of all, in the farms business, we believe that we're getting to stability on that business with significant improvements in quality and customer service. And then in the beverage business, by the end of the fourth quarter, we should be in a situation where we can produce enough product to satisfy shelf stock and also promotion merchandising demands from customers. Today, we're selling what we make. And we can only fulfill shelf stock, although that capacity is getting better with the line that we just put into our own plant, and then the co-packer will get us back to where we can actually supply. We have plans to start to amp up on the beverage business early in fiscal 2018. And we expect, with the right marketing and promotion program with customers, we'll continue to see that business growth. And we are planning on growth for that business next year. From the profit side, we have invested seriously this year in quality and -- but yet, we do expect margin expansion from this business for a couple reasons. First of all, as we've delved into the supply chain, we've been able to realize that we've got opportunities for productivity. And quite frankly, it's a significant portion of the $150 million cost-savings program that we've talked about before. And secondly, we expect margin expansion just from the fact that we'll be growing the CPG higher-margin business at a faster rate than the lower-margin carrot business. So we should have some margin expansion due to mix shifts. So that's how we're looking at it at this point. And of course, we'll keep you posted along the way.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Yes, I'll just add to that, Bryan. I would say that our long-term margin target for C-Fresh is get it -- getting it to 10%, and that's going to take a few years. And I think we'll -- we will make meaningful progress in 2018 against this. We have identified opportunities in procurement. We have identified opportunities in terms of integrating supply chain. And we've identified longer-term back-office consolidation opportunities as well. So we have a pretty robust plan. We think we can get these margins back in the near term and look to make progress next year on it.

Operator

And our next question comes from Ken Goldman of JP Morgan.

Kenneth B. Goldman - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I'm just curious on the cookie side of things, as obviously, one of your biggest competitors is making some pretty interesting changes there. I'm just curious -- 2 parts to this question, I guess. In the near term, are you seeing any particularly aggressive pricing activity, promotional activity from any competitors out there in advance of this change? And then secondly, I'm just curious strategically how you think about what you might want to do with the company to sort of take advantage of some of the transitions that are happening. And I know it's a little early to say exactly what will happen, but I'm just trying to get a little sense of what management's view and outlook is on the situation.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. I mean, the environment in biscuit continues to be competitive, just like the rest of the environment. But we're very pleased with the performance of our Pepperidge Farm and our Arnott's business. I think the competitive situation you're talking about is in the United States. The program that we're running in the biscuit business is we are advertising our brands like Goldfish and Milano. We have increased innovation in all of our brands and with new innovation in Pepperidge Farm farmhouse cookies, which we're excited about. These cookies are clean label, simple ingredients and thinner, crispy. They just provide a different experience. We've also upgraded our classic cookie line to respond to the fact that the market has moved in terms of quality and we need to maintain that edge. And then finally, we have a lot of confidence in our direct store delivery network in terms of their ability to merchandise and work the shelf in store. And we think that combination is serving us well, and our business results are proving that out.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Yes. I would just add with respect to the DSD situation, obviously, we're very aware of what's happening. We're watching it, and we are developing specific plans of our own to take advantage of that situation.

Operator

And our next question comes from Chris Growe of Stifel.

Christopher Robert Growe - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD and Analyst*

I had just a quick, I guess, kind of higher-level question to ask for Denise. And this quarter, you got a bit more promotional, it seemed like, and there were some certain areas of business where you got more promotional. At the same time, private labels got a little bit more price competitive, and retailers seemed to be getting a bit more aggressive with private label we saw, for example, in the broth division. I just want to get a sense of the promotional, I guess, landscape generally. How do you see it kind of trending in the fourth quarter and then the degree to which private label is becoming a bigger threat in some of these categories?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. Well, let me start first with the retailer landscape, which is really competitive. And we've got value players and e-commerce putting pressure on more conventional retail grocery and mass channels. And in that environment, the amp up of promotion and also the push on private label continues to be pretty robust. What we've actually done in terms of our promotional spend is we have spent on broth for the holiday this quarter, and we experienced some lower lifts. We've increased our support -- our promotion support on V8 +Energy because that brand is really gaining a lot of momentum. In -- the rest of our promotional spending has been on Global Biscuits and Snacks. And particularly in Asia Pacific biscuits, we've -- we have a strong promotional program there. And then finally, we did hold our in-season soup prices longer than prior year. And in an EDLP environment, that actually hits the promotion line. But I assure you that we're continuing to manage the depth and frequency of our promotional program while we remain competitive, and we have to do that. And we'll continue to make marketing investments accordingly.

Christopher Robert Growe - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD and Analyst*

Okay. And have you seen private label get more aggressive? Obviously, in broth, that was the case. Is it becoming a theme, though, across more areas?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

And looking at our categories, most of them have -- private label has been pretty much as it always has been, but we did experience an uptick in soup and particularly in the broth area.

Operator

And our next question comes from Matthew Grainger of Morgan Stanley.

Matthew Cameron Grainger - *Morgan Stanley, Research Division - Executive Director*

I just wanted to follow up, I guess, on the same topic. As you're seeing this increased pressure from e-commerce and some of the discounters continuing to build momentum, I know these 2 things aren't separate and distinct, sort of investing in your products as opposed to your distribution platforms, but how does that impact your resource allocations as you think about how to direct investments between offerings and sort of internal resources that could facilitate a stronger presence in those channels and trying to accelerate that shift, as opposed to putting near-term resources toward more traditional things, innovation, merchandising, et cetera, that can help support your traditional retail partners and your categories, help support kind of a return to growth in your categories in those channels?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. Well, suffice it to say that we have always run a multichannel business. And so this isn't the first time that the retail landscape has morphed, although I have to say that I personally have called the shifts to digital and e-commerce a seismic shift. So we are definitely making long -- longer-term plans to address that. But in the current term, e-commerce is about 4% of food sales, and we are setting up resources to address that. But I can assure you that we still have very strong resources against our traditional partners.

Operator

And our next question comes from Jason English of Goldman Sachs.

Jason English - *Goldman Sachs Group Inc., Research Division - VP*

Two questions. First, Anthony, a quick housekeeping item for you. Just to get a little more comfort with the optics of the implied 20% EBIT growth in the fourth quarter, can you quantify how big the cycling of the Bolthouse recall expense is going to be?

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Yes. I'll just go back to what we said last year. Last year, gross margin was down 90 basis points, and we said 70 basis points of that was Bolthouse Farms and 50 basis points was the recall more narrowly defined.

Jason English - *Goldman Sachs Group Inc., Research Division - VP*

Got it. That's helpful. And then a higher-order question for you, Denise. You mentioned mix shift in terms of the AC&T spend that you've had against the business. I think we look industry-wide, we've seen a pretty similar mix shift. The traditional pull-based spend behind the A&C that rolls through SG&A has been shrinking industry-wide for quite a few years now. More and more has moved into trade. And at the same time, volumes have become pretty challenged, private labels making more inroads. You're now seeing the deflationary impact roll through your P&L and pressure margins as well. And you're not alone on that. But it all begs the question of, is this the right move, the right shift? Or has the industry perhaps gone too far? Should we be pivoting back and putting more back into the traditional pull-based marketing? If you could weigh in with your higher order -- or higher-level thoughts on that, I'd appreciate it.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. I mean, it is a -- it's a great question, and we really have to look at the marketing mix by brand and what the brand's objective is and how they're targeting because under the A, there's also been a lot of movement away from classic TV and print and into digital, which creates a whole different kind of marketing content development and a lot of efficiencies there. And we're still all getting better at how we measure effectiveness. But I also think in the A, with the cost savings programs we've been running, we've been doing lots of deep dives into what's working media and what's not working media and how do we make sure we are moving more of our dollars to work harder for us. So that's the high-level answer on A. Of course, we're watching some of the shift to T, where we've got a very robust revenue management analytics group that supports our marketing and our sales force. They are looking at net price realization because it's not only list price. It's also EDLP. It's also promoted price points. And so those vary by brand, but they're all tucked into the T part of ACT. And then finally, we're also seeing a bit of an uptick in shopper marketing, and that's involved in that T as well. So again, I think it's really hard to give you a one-size-fits-all answer, but this is a hypercompetitive marketplace, and you've got to be agile in terms of how you run the business to make sure that we're remaining competitive. And we're proud of the fact that despite the difficult environment, we have been able to maintain our market share across 75% of our business.

Operator

And our next question comes from Alexia Howard of Bernstein. And our next question comes from David Driscoll of Citi.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

I had just a quick follow-up on the quarter and then a question about C-Fresh. So if the quarter turned out worse than you expected, I just don't think I'm clear on why you're raising the bottom end of your EPS guidance. I know it's just a small change, but it just wasn't clear to me what got better that made you wanted to raise that bottom end. If you could start there, and then I had a quick one on C-Fresh.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Yes, I think the quick answer to that is we weren't near the low end of those earnings ranges before the quarter. So we're just -- with one quarter to go, we thought it's prudent to tighten them up a bit. And again, we are already up -- above the low end before.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

Okay. That's fine. And then on C-Fresh, did the -- was the revenue guidance reduction in significant part related to underperformance of C-Fresh revenues in the quarter? And if that's true, can you just talk a little bit more about your confidence in why this business can get back on track? I mean, have you lost shelf space for the CPG beverages? What's the consumer impression of the brand given the difficulties that it had? I just -- I feel like the quarter didn't come out as you had hoped. And I'm just concerned that, that has implications on C-Fresh going forward.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

I'll take the first part. The revenue guidance reduction does not stem from changes in C-Fresh. It's related to the performance of our shelf-stable businesses in the U.S.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

And I'll take the second part. David, recall that we put a new leadership team into C-Fresh earlier this year. And their mandate was to conduct a deep-dive strategic review of the business. And we even retained help to do that, so that we made sure that we had a real objective look and we were not talking to ourselves. And so this team did an exhaustive review of the categories, the opportunities, the potential for the business. As we've got our capacity back up, we looked at both the CPG businesses. We really looked at the beverage business. And then we also looked at the farms business. And they came back confirming the potential of the business to deliver growth in excess of our long-term targets and at multiples of center-store categories. So we will be running that play. That is a 3-year strategic plan that they created, and that will go into the next year's operating plan. So we really took this opportunity in a tough situation to go all the way back to go and say, "What did we assume when we bought this business? And are those assumptions still valid? And how do we see the potential of this business?" And quite frankly, with the consumer shifts to fresh, we think that going forward, we're in a good -- we're going to be in good position to capitalize on that shift.

Operator

And our next question comes from Rob Dickerson of Deutsche Bank.

Robert Frederick Dickerson - *Deutsche Bank AG, Research Division - Research Analyst*

I just had bit of a general question on Pepperidge Farm in the U.S. and the distribution model that you use there under IBO. It seems like Pepperidge, obviously, is one of your stronger brands and continues to do well via innovation, given I understand that the category has always remained competitive. But if you kind of view that distribution model, for the time being at least, as a competitive advantage, then why haven't you and why wouldn't you consider placing more product on those routes to essentially push more into smaller stores and faster-growing channels, et cetera, rather than just kind of constrain it under the current brands?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. You -- look, we run 3 different kinds of supply chain here. We run a warehouse supply chain. We run a fresh supply chain. And then in Pepperidge Farm, as you indicate, we run an independent distribution system through DSD. These distributors are entrepreneurs, and they've built a great business. In the snacks business, you do see a portion of the business in warehouse snacks, but you also see a large portion of the snacks business, whether it be sweet, savory or salty, in DSD. So we still believe in the model for this category. And the operations part of it calls for a very focused category distribution. And that's where you can get the maximum effectiveness and efficiency. In fact, we have 2 separate DSD networks, one for bakery and one for snacks, because of that reason. And we do believe that DSD also helps with the quality of the product and making sure that we're working the shelves every day.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

I would just add that in terms of the latter part of your question, we don't feel that we're constrained by just Pepperidge Farm products. We do think we have the velocity and the volume to push into the smaller stores and push into the growing channels. We continually look at the system. Sometimes, we split routes to make them smaller to enable that kind of enhanced distribution. But again, we don't think we're constraining our growth.

Robert Frederick Dickerson - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. Great. And then just quickly, the fresh bakery, you've called out as seeing some, I think, increased competitive pressure. Just simple drivers as to what's going on there.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

The fresh bakery, we've been under pressure with Swirl bread and Sandwich Bread. We have now increased the quality and reformulated our Swirl bread. And we're out with a new Sandwich Bread offerings. So we believe we've responded to that. And our buns and roll business continues to be really robust, and we'll be continuing to push that one. So bakery was down slightly.

Operator

And our next question comes from Jonathan Feeney of Consumer Edge.

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst*

When I look at this Q4 margin at the midpoint, midpoint to midpoint, it's like 17.8%, which would be the record by, as far as I know, forever, for the last 10 years. And you've typically -- there's a seasonality in this business that makes this one of the lower-margin quarters. So on the things -- I don't think -- it doesn't seem like, at least over the past few years, that much has changed in terms of the seasonality of margins. So are the things you're doing here in the fourth quarter indicative of a structural progress in margin going forward? And if you could comment about how that breaks down.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Yes, Jonathan, I would say no is the short answer. I think what happened, as you get into our fourth quarter, which is relatively small, so any changes that we make, it's kind of exacerbated at the margin. But as we look at it -- and look, we've always expected a robust fourth quarter and there are several key drivers. One is the significant expansion in gross margin. We're lapping a 90 basis point decline last year, most of which was driven by Bolthouse. We will benefit from incremental cost savings coming through our supply chain as well as our ongoing productivity program, which has been performing really, really well. As Denise mentioned, we are cycling a very high level of marketing investment. And I think it went up about 150 basis points last year. We'll return to more kind of normal levels. And lastly, our GBS business had a really strong third quarter. We anticipate it'll have another strong quarter in the fourth. So if you look at all those factors together, we're pretty confident in our guidance.

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst*

So just to follow up on that, Anthony. Everything but the GBS -- those are like relative changes year-over-year, and I completely get that. It's a big move year-over-year. But in the absolute, all of those things are things that will presumably persist into fiscal '18. So starting with global -- Global Baking and Snacking, we don't know what the trends are going to be going into fiscal '18. So it's probably like -- it sounds like a lot of this is structural progress on -- productivity in the business and maybe partially held back by C-Fresh productivity.

Anthony P. DiSilvestro - *Campbell Soup Company - CFO and SVP*

Yes, I think that's a good way to look at it. If you go back to last year, our fourth quarter was very weak. And we had a great year in terms of generating cost savings. So I think our fourth quarter last year didn't really reflect many of the things that we've been working on, and those are going to come through this year.

Operator

And our next question comes from John Baumgartner of Wells Fargo.

John Joseph Baumgartner - *Wells Fargo Securities, LLC, Research Division - VP and Senior Analyst*

Denise, I'd like to come back to C-Fresh for a minute, and specifically on the carrot side. I think it was about 2 years ago where there was a bit of optimism that you'd be able to enhance some of the growth in margins by moving more into snacking and convenience. I think one of the products you were testing was called ShakeDowns. But more recently, we haven't really heard a lot about that push. So I'm curious, with this new management team coming in, will those opportunities still exist? And kind of how you're thinking about those options?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Yes. Well, just to specifically answer your question in ShakeDowns, we actually have ShakeDowns in a couple of these -- the school systems in the country. We've moved those more out of retail and into working with schools to give kids healthier snacks. In terms of the new management team coming in, their first and foremost objective is -- now that we've got our quality and our customer service back, is to make sure that we're sharing up our business with customers and making sure customers are happy. In addition to that, we will innovate some things in carrots. For example, one of the things they have are rainbow carrots, where we've been able to grow different color carrots. And we're working with those in a few retailers. But I think, suffice it to say, that most of the innovation will happen in the CPG business. That's where we really are pushing innovation, but we will do enough in carrots to make sure that we're keeping that business stable to modestly growing.

John Joseph Baumgartner - *Wells Fargo Securities, LLC, Research Division - VP and Senior Analyst*

And then just as a follow-up. In that CPG business, especially on the beverage side, it feels like as though that shelf space is becoming a lot more competitive, a lot of new entries in there. Can you just speak a little bit of the competitive dynamics that you're seeing on the -- in the refrigerated shelf?

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

I'm not sure I understood your question. What business were you talking about?

John Joseph Baumgartner - *Wells Fargo Securities, LLC, Research Division - VP and Senior Analyst*

On the refrigerated beverages side. Just seeing a lot of new brands popping up in the category.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Okay. Yes, I mean -- yes, I think the refrigerated beverage business is very competitive. And we have seen the advent of ultra-premium juice, the fermented juices coming -- or fermented beverages coming in. But we do believe we have a great product and we have a range across super premium and premium juice. We've been, again, strapped because we haven't had the supply and the capacity to meet that increased demand. So next year, we'll be running a full play.

Operator

And that concludes our question-and-answer session for today. I'd like to turn the conference back over to Mr. Gosnell for any closing remarks.

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

Thanks, everyone for joining -- sorry.

Denise M. Morrison - *Campbell Soup Company - CEO, President and Director*

Thank you.

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

Thanks, everyone, for joining our third quarter earnings call and webcast. A full replay will be available about 2 hours after the call by going online or calling 1 (404) 537-3406. The access code is 6692640. You have until June 2, 2017, at midnight, at which point, it will move strictly to the website. If you have further questions, please call me, Ken Gosnell, at (856) 342-6081. If you're a reporter with questions, please call Carla Burigatto, Director of External Communications at (856) 342-3737. And that's it for today. Thanks, everyone.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.