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CPB - Q1 2015 Campbell Soup Co Earnings Call

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OVERVIEW:

Co. reported 1Q15 net sales of $2.255b and adjusted EPS of $0.74. Expects FY15 sales growth to be 0% to plus 2% and adjusted EPS to be $2.42-2.50.

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PRESENTATION

Operator

Good day ladies and gentlemen and welcome to the Campbell's Soup first-quarter 2015 earnings call. (Operator Instructions). As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Jennifer Driscoll, Vice President Investor Relations. Please go ahead.

Jennifer Driscoll - *Campbell Soup Company - VP of IR*

Good morning everyone. Welcome to the first-quarter earnings call for Campbell Soup fiscal 2015. With me here in New Jersey today are Denise Morrison, President and CEO; Anthony DiSilvestro, Chief Financial Officer; and Anna Choi, Senior Manager of Investor Relations.

We will start with a few housekeeping items, then Denise will offer her perspective on the quarter and our progress with our F15 objectives. Anthony will discuss our financial results for the quarter before elaborating on our expectations for fiscal 2015. After that we will take your questions.

As usual we have created slides to accompany our presentation. You will find the slides posted on our website this morning at investor.campbellsoupcompany.com. Our call is open to the media who are participating in listen-only mode.

You probably noticed this morning that we reformatted our earnings release in an effort to enhance readability. We made the changes based on feedback from you, our investors and analysts. We hope you will agree that the new earnings format as well as the enhancements we made to our earnings call will make it easier for you to understand the business and to find the key points. Thanks for those of you who offered input and let us know if you have feedback on our changes.

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 four or to our SEC filings for a list of the factors that could cause our actual results to vary materially from those anticipated in our forward-looking statements.

While in the current quarter we had no new items affecting comparability, our comparisons of fiscal 2015 with fiscal 2014 will exclude previously announced items.

Because we use non-GAAP measures, we provided in our appendix a reconciliation of these measures to the most directly comparable GAAP measures. With that, let me turn the call over to Denise Morrison.

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

Thank you, Jennifer, and good morning, everyone. Today I'm going to share my perspective on our first-quarter 2015 performance. I will review the key drivers of our results including our positive organic sales performance across most of our core and acquired businesses. Then I will discuss the challenges we are facing and the actions we are taking. Our challenges include our gross margin performance and the impact of currency headwinds which Anthony will review in greater detail in his presentation.

As a reminder we said on September 8, that we don't expect our growth in fiscal 2015 to be evenly distributed across quarters. As a result, we believe that evaluating our business performance on a first-half basis rather than a quarterly basis will be more meaningful.

Let's start by examining the key growth drivers in our core business in the quarter.

I was pleased that we drove top- and bottom-line growth in US simple meals with higher sales in our US soup portfolio. Our US soup performance benefited from a stronger seasonal sell-in and the timing of our quarter end relative to the Thanksgiving holiday. As we have stated, one of our strategic priorities is to expand our presence in the faster growing premium soup segment which represents roughly 10% of the wet soup category. We made good progress as we launched new Slow Kettle varieties in the quarter to drive the brand's double-digit sales growth.

Many of our retail customers have created dedicated shelf space for our premium soups where we have gained additional linear feet. The next step in our plan is to expand further with the launch of six varieties of Campbell's organic soup in easier to open cartons this January.

Another key driver in US Simple Meals was our strong performance in sauces including Prego, Pace and Campbell's Dinner Sauces as we introduced new products and leveraged merchandising. We expanded our Dinner Sauces platform beyond skillet and slow cooker pouches with the launch of Oven Sauces in the quarter which has quickly achieved 52% ACV. Overall, Campbell dinner sauces now have over 80% ACV with dedicated sections that are becoming a consumer destination.

Within Global Baking and Snacking, a significant improvement in our core business was our performance in Australian biscuits. We are moving in the right direction to stabilize the business in Australia where we drove Arnott's sales and earnings. Our team grew consumption and share in total biscuits by strengthening planning and execution with our retail partners, increasing marketing and promotion behind core brands, and driving innovation including new Tim Tam varieties and light and crispy Arnott's Shapes.

I was also pleased with the continued strong growth in our Indonesia business which expanded beyond sweet biscuits into savory crackers with the introduction of Arnott's Shapes.

Now let's look at the performance of the trio of growth engines that we acquired in the last two years, Bolthouse Farms, Plum Organics and Kelsen. Strategically we acquired these businesses to expand into faster growing spaces and respond to the seismic shifts in the consumer landscape including the focus on health and well-being and the growth of the middle class in developing markets. Together these businesses contributed 1 point of organic sales growth to our Company in the quarter.

We were encouraged by Bolthouse Farms strong topline growth. We continue to expand distribution in package fresh super premium beverages and fresh salad dressings. Bolthouse Farms has strengthened its number one share position in premium beverages over the last year while simplifying and streamlining its beverage portfolio, increasing space for higher velocity offerings and reducing out of stocks.

During the quarter, we also launched Bolthouse Farms Kids, the brand's first line of healthy beverages and veggie snackers for children. We are merchandising Bolthouse Farms Kids with a dedicated shelf set in the fresh produce section to further expand our position in the fast-growing perimeter. Our goal is to become a branded leader in the $18.6 billion packaged fresh category.

Plum Organics delivered double-digit sales growth after facing challenges a year ago. As the number one brand in the organic segment of the US baby food market, Plum continued to expand distribution and drive innovation in simple meals and snacks. We are continuing to integrate Plum to leverage Campbell's scale and amp up its expansion while maintaining its entrepreneurial spirit.

Kelsen, which we acquired early in last year's first quarter to expand our global snacks business, delivered higher sales as it continued to meet our expectations. We are focused on expanding distribution in key cities in China. The second quarter historically marks the peak season for Kelsen sales and earnings as authentic Danish butter cookies are often exchanged by friends and families in China as gifts for holidays and festive occasions including Chinese New Year's.

Now let's take a look at some of our challenges and how we are addressing them. I am going to focus my remarks on two businesses that underperformed, Pepperidge Farms and U.S. Beverages. But before I get to those, let me say that our gross margin performance in the quarter did not meet our expectations. Some of the pressure came from higher than anticipated commodity inflation and some came from unexpected costs in our supply chain including manufacturing and transportation costs. Anthony will describe these issues in greater detail in a few moments. We are taking action to manage costs aggressively and working all the levers to mitigate the unexpected pressure on gross margin.

Turning to the businesses, Pepperidge Farms performance in the quarter was mixed. I was pleased with our growth in cookies driven by Milano and Crispy Pepperidge Farm varieties. We also drove strong results in fresh bakery which continued to outperform the market with consumption and share gains. Fresh bakery benefited from our focus on seasonal offerings and quality improvements. Our main challenge in this business is to restore growth in crackers.

It is important to examine the total cracker category. For the past two years, dollar consumption growth trends have slowed in the category and were flat to declining in the quarter. We see several crucial drivers in this category deceleration. First, we are seeing a shift in consumer snacking preferences. About half of cracker consumers are buying crackers and others snacks less frequently and when they do they are shifting in some cases to snacks that are better for you or on the opposite end of the spectrum, more indulgent snacks.

Second, approximately three quarters of the losses in the total category have been in sandwich crackers where we don't compete. Third, total advertising in the category has declined more than 20% in the last year impacting velocities as price and distribution held. Finally, there has been a decline in the number of new products introduced in the category resulting in less excitement from innovation in the cracker aisle.

In this environment some major brands have continued to outpace the category. One of those brands is Goldfish which has consistently outperformed the category over the last three years. In the first quarter despite growing consumption and share and outperforming the category, Goldfish sales declined due in part to cycling the distribution build of the launch of Goldfish Puffs. We are not satisfied with this performance given the brand's steady track record of growth over many years.

We continue to expect Goldfish sales to be up for the year behind strong holiday programs, increased advertising and consumer promotion and improved in-store merchandising. Going forward, we are increasing advertising by about 20% with a quarter of our spend in digital media. Our plans include increased innovation including new flavors of Goldfish and Goldfish Puffs.

Turning now to U.S. Beverages. Although we grew operating earnings, sales of V8 V-Fusion and V8 Vegetable juice declined as shelf stable category remained under pressure. Our plans to revitalize our V8 platform are underway. The next step is the January launch of V8 Veggie Blends. We are optimistic about this launch as we plan to tap into the juicing trend by offering nutritious affordable juicing that is convenient for the consumer.

Separately in the quarter we extended the V8 brand to a new category with the launch of V8 protein shakes and bars to expand into the adult on the go nutrition, a multibillion-dollar category. This is another example of our focus on driving breakthrough innovation to expand into faster growing spaces.

So looking ahead, although we face more challenging comparisons, we are confident about our plans for the year which include driving continued growth in U.S. Simple Meals, continuing our turnaround in Australian biscuits which moved in the right direction in the first quarter, restoring growth in Goldfish crackers and improving Pepperidge Farms topline performance, revitalizing V8 to bring news to the shelf stable juice category and delivering strong performance in Bolthouse Farms, Plum Organics and Kelsen.

Across our portfolio we are responding to the consumer shift to health and well-being with new on-trend products ranging from Campbell's organic soups and V8 Veggie Blends in the center of the store to Bolthouse Farms Kids in the fresh perimeter and V8 protein shakes and bars in the health and beauty aisle. Finally, we are taking action to mitigate gross margin pressure in the remainder of the year.

To sum up, we delivered organic sales growth across most of our core and acquired businesses in the first quarter with stronger performances in U.S. Simple Meals and Global Baking and Snacking. We have more work ahead and challenges to overcome this year but we remain focused on our strategy to strengthen our core business and expand into faster growing spaces to reshape our portfolio for a more profitable growth trajectory.

I look forward to answering your questions in a few minutes. Now let me turn the call over to Anthony for a detailed review of our financial performance.

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

Good morning and thanks, Denise. Before getting into the details, I wanted to give some perspective on our results and guidance. As Denise said, we are encouraged with our topline performance as we start the fiscal year. However, this topline performance is dampened by gross margin pressure on higher than anticipated cost inflation and supply chain related costs.

The other item I want to call out is currency. Due to the recent and significant strength of the US dollar against most major foreign currencies, we are seeing a negative impact that we did not forecast. Based on this headwind and volatility from currency translation, we have reduced the low end of our guidance ranges. Importantly, our currency neutral expectations have not changed.

Now I will review our results. First-quarter net sales increased 4% to $2.255 billion. Organic net sales increased by 5% with volume and organic sales gains in four of our five reportable segments. Sales in the quarter benefited from movements in retailer inventory levels from a stronger seasonal sell-in and the later timing of our quarter relative to the Thanksgiving holiday. In aggregate, the movements in retailer inventories represent about half of our organic sales gains in the quarter.

We are encouraged by the sales performance in Australia and from the performance of our recent acquisitions as Bolthouse Farms, Plum and Kelsen contributed 1 point of total Company organic growth in the quarter. Adjusted EBIT increased 9% reflecting the higher sales, the benefit of lapping the prior-year Plum recall and lower administrative and marketing expenses which were partly offset by the decline in our gross margin percentage. Adjusted earnings per share increased 12% to $0.74.

Decomposing our sales performance, favorable volume mix was the main driver of the increase primarily in the U.S. Simple Meals and Global Baking and Snacking segments. Overall, increased promotional spending was negatively impacted sales by 1 point. While our promotional rate was stable in our largest segment, US Simple Meals, the increase was driven by higher rates of spending in the Global Baking and Snacking segment. Currency also negatively impacted sales by 1 point as our two primary foreign currencies, the Australian dollar and Canadian dollar both weakened against the US dollar.

We are disappointed with our gross margin performance which did not meet our expectations. The bridge on this chart highlights the factors impacting our performance. First, cost inflation and other factors had a negative impact of 340 basis points. Most of this was cost inflation which as a rate increased by almost 4%. Recent and unanticipated increases in dairy, beef and aluminum have added to the overall inflation impact.

Also with pressure on carrier capacity, we are seeing much higher freight costs. For the full fiscal year, we now anticipate cost inflation at the high end of our 3% to 4% range.

In our North American supply chain, we experienced higher than expected manufacturing and freight costs from significant volume demand early in the quarter. As a result, we ran production more weekends, increased the use of co-packers and incurred higher freight costs in the spot market.

Promotional spending negatively impacted gross margin by 70 basis points primarily impacted by higher spending in the Baking and Snacking segment and while volumes increased in the segment, trade had a negative impact on margin.

Moving to the right as we wrap both the Plum recall and the one-time purchase accounting impact on the Kelsen acquisition, these represent a 90 basis point gain. Lastly, we continued to drive meaningful productivity gains in our supply chain which contributed 140 basis points of improvement.

Looking ahead, reflecting our revised inflation outlook and first-quarter performance, we now expect our gross margin percentage for the full year to decline 50 to 100 basis points due largely to the residual cost inflation and cost to maintain our customer service levels as we recover from the early spike in demand. Longer-term, our investments in soup common platform and broad capacity will increase our flexibility to respond to volatility in demand. Importantly, we will manage the balance of the P&L to mitigate the negative impact including our overhead and supply chain costs and our marketing programs and also evaluate price realization opportunity.

Marketing and selling expenses decreased 5%. As you may recall, we increased advertising in the prior-year quarter to support new product launches in Bolthouse Farms. Marketing reductions in the current quarter reflect lower advertising spending in U.S. Simple Meals primarily advertising and production costs and a shift in advertising in U.S. Beverages to the back half of the year to support the launch of our new V8 Veggie Blends platform.

Administrative expenses were down 9% driven by lower long-term incentive compensation costs and cost savings related to prior year restructuring initiatives. Given that our annual cycle for long-term incentive compensation is at the end of the first quarter, we had favorability through this quarter and as we have discussed previously, expect a significant headwind for the balance of the year.

For additional perspective on our performance, this chart breaks down our EPS growth between our operating performance and below the line items. As you can see, we grew adjusted EPS by $0.08 per share, $0.07 of which is attributable to the growth in EBIT. Net interest expense declined $5 million versus a year ago as we reduced our debt level using the proceeds of the European Simple Meals divestiture and this contributed a penny to EPS growth in the quarter.

Our tax rate remained relatively flat declining 40 basis points to 31.8%. We resumed repurchases under our strategic share repurchase program in the quarter repurchasing 50 million under this program. However, given the timing, there was no impact on EPS growth in the quarter.

While currency had a 1 point impact on sales, it did not impact EPS in the quarter. For the full year and based on current exchange rates, we estimate currency will have a $0.03 per share negative impact. As this was not anticipated, we have adjusted the lower end of our guidance range to reflect the impact.

Now turning to our segment results, sales growth in U.S. Simple Meals was 8% driven by strong volume gains. U.S. Soup sales increased 6% benefiting from movements in retailer inventory levels due to a strong seasonal sell-in and the later timing of our quarter end relative to the Thanksgiving holiday. Sales of other Simple Meals increased 14% driven by growth in Plum, Prego benefiting from white sauces and in our dinner sauce platform which now includes oven sauces. Operating earnings for U.S. Simple Meals increased 15% with 8 points of the growth due to cycling the Plum recall in the prior year.

In Global Baking and Snacking, we achieved 3% organic sales growth driven by the improve performance of Arnott's. We are pleased with our consumption and share gains in the Australian biscuit category given our previous challenges while Indonesia delivered another quarter of double-digit sales gains.

Within Pepperidge Farm, fresh bakery and cookies sales grew. Goldfish crackers had share gains but sales declined. Sales of frozen products were also soft. Operating earnings for Global Baking and Snacking increased 15% of which 10 points was due to wrapping the negative impact of purchase accounting on the Kelsen acquisition in the prior year.

In the Bolthouse and Foodservice segment, growth continued to be driven by sales gains in Bolthouse premium beverages and salad dressings. The decline in operating earnings was primarily driven by a lower gross margin percentage with cost inflation across the segment.

International Simple Meals and Beverages grew organic sales by 5%. Strong sales gains in Canada were driven by innovation and higher levels of promotional activity. Declines in operating earnings reflect the impact of increased marketing support. U.S. Beverage sales fell 3% on declines in the immediate consumption channel as we continued to implement our new route to market.

Across the portfolio, sales declines in V8 V-Fusion and V8 Vegetable juice more than offset gains in V8 Splash. Operating earnings improved as we shift the timing of our marketing programs to the back half to support the launch of the Veggie Blends platform.

Within U.S. Soup, the 6% sales growth was driven by gains in condensed and Swanson broth. Condensed eating and cooking varieties rose. Swanson broth continues to perform well in the marketplace led by aseptic broth which benefited from earlier holiday shipments. Sales of ready-to-serve soup were comparable to the prior year as declines in volumes were partly offset by lower promotional spending as activity was shifted to the second quarter of this year.

While our soup sales increased 6%, consumer take away in measured channels for the comparable 13-week period ending November 2 declined by 2%. Here is a look at U.S. wet soup category performance and our share results as measured by IRI. For the 52-week period ending November 2, 2014, the category as a whole declined 0.5%. Our sales in measured channels declined 1.6% with weakness in condensed and ready-to-serve soups partly offset by strength in broth. Campbell had a 59% market share, a decrease of 70 basis points. All other branded players collectively had a share of 28% with gains driven by smaller players. Private label also grew share finishing at 13%.

We had strong cash flow performance as cash from operations increased from $38 million to $188 million reflecting lower working capital requirements, lower pension contributions and reduced payments related to hedging activities. Capital expenditures increased slightly to $62 million. We continue to expect capital expenditures of about $400 million for the year as we increase capacity to support growth in our faster growing business.

We paid dividends totaling $101 million reflecting our current quarterly dividend rate of $0.312 per share. In aggregate, we repurchased 73 million of shares in the quarter, 50 million of which were under our strategic share repurchase program. The balance of the repurchases were made to offset dilution from equity-based compensation. Based on our current investment plans, we anticipate making strategic share repurchases at this pace on average for the balance of the year.

Net debt declined almost $700 million to $3.8 billion including the proceeds from the European Simple Meals divestiture.

Approximately 22% of our sales are denominated in currencies other than the US dollar with the Australian dollar and Canadian dollar making up the majority of our non-US sales. Since September, both of these currencies have declined in value relative to the US dollar and while not a material impact to our first quarter, if the current rates hold for the balance of the year, we will see a more meaningful impact. At current exchange rates, we estimate it to negatively impact our full-year performance by 1 percentage point of sales, EBIT and EPS and is the reason we are adjusting down the lower end of our guidance ranges as illustrated on the next chart.

As we announced earlier this morning, we have adjusted our fiscal 2015 guidance as shown. Our currency neutral expectations have not changed for sales and earnings. While we now anticipate some pressure on our gross margin percentage, we have plans in place to mitigate the impact. We now expect sales growth of 0% to plus 2%, adjusted EBIT from minus 1% to plus 2% and adjusted EPS from minus 1% to plus 2% or $2.42 to $2.50 per share.

As we said previously, we anticipated stronger first-quarter performance and because we are cycling a more robust second quarter last year, we expect a first half that is more consistent with our full-year guidance.

Thank you. Now I will turn it back to Jennifer.

Jennifer Driscoll - *Campbell Soup Company - VP of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Alexia Howard, Sanford Bernstein.

Alexia Howard - *Sanford C. Bernstein - Analyst*

Good morning, everyone. Denise, you mentioned once or twice the fast-growing perimeter of the store. From what you have seen, are the retailers expanding fridge space at the moment and what does this mean for the shelf space in the center of the store? Obviously it is great for Bolthouse, might be more difficult in the ambient product. Thank you.

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

Thank you, Alexia. We have seen over the past several years an expansion and a build out of the perimeter of stores. Within the produce section however, the additional space that we are getting for the Bolthouse Kids launch is largely a reconfiguration of existing space so pulling from other things in produce and carving out a section for Bolthouse Kids. And that has been largely the way the premium beverage and the salad dressing sections have been expanded as well.

So I think it is more, yes, perimeter space continues to expand and then within the produce section there has been a larger dedication of space to CPG items.

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

I would add to that, if you look at the center of the store and our soup business, I mean given the level of innovation we are bringing to the market with the premium expansion and soon the organic soup launch, we are expecting to gain shelf space in our soup category.

Alexia Howard - *Sanford C. Bernstein - Analyst*

Thank you very much. I will pass it on.

Operator

David Driscoll, Citi.

David Driscoll - *Citigroup - Analyst*

Thank you and good morning. Wanted just to pull a little bit more on this gross margin issue. I mean this looks to be a fairly significant issue. I think, Anthony, you said now down 50 basis points to down 100 basis points for the full year and previously the expectation -- correct me if I am wrong but it was up modestly was the prior expectation. Is that correct?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

I think we said it was expected to be stable so versus stable yes, we are now looking to be down 50 to 100 basis points. And just to dimensionalize that, we did not anticipate that recent increases in dairy, beef and aluminum and also what freight costs are doing and that is the majority of that 50 to 100 basis point decline. The other piece of it is higher than anticipated supply chain costs related to that early spike in demand that we had to deal with.

David Driscoll - *Citigroup - Analyst*

May I say that I always thought that you had a pretty good visibility on the protein side because of your relationships with your suppliers and that these things didn't just suddenly come up. And I thought the entire purpose of that was that gaining pricing in soup during soup season is like all but impossible. So maybe is my recollection of history correct and kind of why is it different this time?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

We have a pretty broad array of input costs and certainly on protein that is a significant part of it and we do have good relationships obviously with our suppliers but the markets have been extremely volatile and I don't think we are the only ones that are seeing this type of activity. There has been issues on the supply side related to the drought, there have been issues on the demand side related to foreign buyers and this just created a lot of volatility that frankly we didn't anticipate.

David Driscoll - *Citigroup - Analyst*

And the way you offset this is by number one, it is going to be lowering marketing spending and then number two, lower overhead spending? Do I have that in the right order?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

I would switch the order of that and I would also add that we are evaluating price realization opportunities and also pushing on our supply chain to one, fix the problem and to contribute to those cost savings.

David Driscoll - *Citigroup - Analyst*

Super. Thank you. I will pass it along.

Operator

Chris Growe, Stifel.

Chris Growe - *Stifel Nicolaus - Analyst*

Good morning. I just had a quick question for you if I could. If you look at this quarter you are getting what seems to be an increasing contribution from the sauces business within U.S. Simple Meals in particular as well as premium soups. I wondered if you could give a little color around how those two products benefited the sales for that division in the quarter. Maybe related to that, ready-to-serve was a little weaker than I thought against a relatively easy comp. Premium soups would fall into ready-to-serve I presume. I wanted to make sure I was clear and then understand why that was a little weaker than I thought.

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

First of all, we have had for the past several years a very good run with our base sauce businesses particularly in the Prego line. Recall part of our innovation plan was the successful launch of Prego white sauces which has done incredibly well. We have increased our advertising against the brand. We were also advertising to Hispanics which has been very productive for us. So we are very pleased with the innovation and the brand building that has gone on in our base sauce businesses. And Pace also had a very good quarter.

One of the things that is also impacting our sauce business is the building of the dinner sauce platform and although it started small with one initiative in skillet, as we built from skillet to slow cooker and now introduced oven, as we have gained an additional section in the store to house these sauces and create a consumer destination, we really believe that has added seriously to our sauce performance and of course this is a very good margin business for us as well.

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

The only thing I would add to that is Plum is reported inside of Simple Meals and it had a significant increase in sales in part due to wrapping the recall in and in part due to expanded distribution.

Chris Growe - *Stifel Nicolaus - Analyst*

So within in ready-to-serve presumably premium soups grew, that was a contributor to growth in the quarter. Was there one element of ready-to-serve that was weak whether it be chunky or home style?

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

Yes, there was a very good reason for that. Our ready-to-serve business was relatively flat and that comes mostly from promotional timing moved to the second quarter out of the first quarter relative to last year.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay, thank you.

Operator

Ken Goldman, JPMorgan.

Ken Goldman - *JPMorgan - Analyst*

Good morning, everyone. Denise, you have spoken in the recent past I think about course correcting deals a little bit -- deal backs -- by going deeper in terms of discount but maybe a little bit less broadly. I am just curious if this is still the plan because we look at Nielsen data, we are seeing deeper levels of price discounting, you are doing what you said but we are not really seeing a change in the percent and lift from promotion. So I am just curious how you think about that breadth versus depth decision going forward here?

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

We do expect our total marketing to be in the range of 24% to 25% of total list sales. So within that, the mix will be different by category and we do recognize, we are very diligent about going back and looking at the productivity of our trade spending and we recognize that some of this spending last year particularly in Pepperidge Farm and in soup did not achieve the anticipated lifts. Predominantly it came from increasing the frequency of promotion so we do we expect our overall trade rate trends to improve in the second half as we have course corrected in this area.

Ken Goldman - *JPMorgan - Analyst*

Thank you.

Operator

Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Thank you. So I guess I was wondering about this unexpected spike in demand. If we look at the sales in the quarter, they didn't come in that different from what we had modeled and I don't think it came in that different from what you had modeled. So was this a specific customer making a last-minute decision that you felt like you had to react to?

Secondly, gross margin being down 130 basis points despite volume being up, Anthony, was there any kind of overhead absorption benefit from all this volume? And if so -- if not, why not?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

Let me start with the last part of that question. No, there wasn't an absorption benefit because we still expect to make the same full-year production so it was just moving fixed cost with those cases between the quarters so on a rate per case basis nothing really changed.

In terms of the volume spike, what you don't see when you look at the quarter is the monthly variations and we had very strong volume demand early in the quarter so August, September and it is not a particular customer, it has to do with just overall programming and the timing of which customers place orders. So in order to meet the customer service requirements, we had to run some more overtime, we had to run some more weekends and obviously that cost us a bit more and we also had to get into the freight market on a spot basis so that is obviously a little more expensive.

So it is going to take us a little while here to catch up with that requirement but we would foresee improvements when we get to the second half of the year.

Robert Moskow - *Credit Suisse - Analyst*

Okay. Was it on a specific line of products or not?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

It is mostly in our soup and sauce business in the US.

Robert Moskow - *Credit Suisse - Analyst*

Okay, thanks very much.

Operator

Eric Katzman, Deutsche Bank.

Eric Katzman - *Deutsche Bank - Analyst*

Good morning. Happy holidays to you and your family. I want to follow-up on Rob's question because I think it goes to the point. Obviously we knew the timing of Thanksgiving and you kind of have said that the shipments were well ahead of consumption. So the first part is what are we looking for from sales in the second quarter given how much it seems like there was over shipment versus consumption?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

That is a good point. We, as you know, benefited from the retailer inventory movement last year's first quarter relative to this year's first quarter and when you look at where we ended this quarter, it is within kind of the historical ranges but we are a bit higher than where we were last year. So it is hard to predict exactly when that will come out but it could put some -- be a little bit of a headwind for us on second quarter topline.

And as we have also said, we did expect a stronger first quarter and a relatively softer second quarter and to finish the half with results more in line with our full-year guidance. So it is not unexpected but again, the thing that we didn't expect was within the first quarter the acceleration to the earlier month or two.

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

We actually had a stronger sell in against back to school and as predicted, had our holiday shipments -- some of our holiday shipments ship in October and in the soup business at least, about 75% of our consumption actually occurs in the second and the third quarters.

Eric Katzman - *Deutsche Bank - Analyst*

Okay, and then, Anthony, I don't understand your answers to Rob's question about the volume lift and the absorption. So are you saying that you basically just regardless of quarterly volume you basically spread the fixed cost over the entire year, kind of like on some kind of basis as opposed to kind of counting it more specifically within the quarter?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

No, it actually goes with the volume so you figure out fixed cost per case and you recognize those fixed costs as you sell them so it is not a straight line, it moves with the volume.

Eric Katzman - *Deutsche Bank - Analyst*

Right, so with the volume so strong in arguably the highest margin products that you have, I guess you just must have paid extraordinary cost on the freight market and I would assume Pepperidge Farm and Goldfish is a very high margin product. Was that also an offset? Because otherwise my guess is most investors are saying that this would have been a much bigger margin quarter.

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

You referenced a mix benefit and we do see that and you saw it on the gross margin bridge that I reviewed. So we are seeing that mix benefit but as I said on a fixed cost per case basis, we don't necessarily see that but we do see it in the mix line. So I think there is 30 or 40 basis points of mix benefit given the performance of soup and some of our higher-margin business relative to the balance.

But that being said, the inflation impact on dairy, beef and aluminum and freight is about half of that gross margin miss and the other half is the supply chain related costs which aren't insignificant and did hurt our gross margin performance in the first quarter.

Eric Katzman - *Deutsche Bank - Analyst*

All right. I will respect the time. I will pass it on and we will follow up on this. Thanks.

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

It was 40 basis points mix benefit.

Operator

David Palmer, RBC Capital Markets.

David Palmer - *RBC Capital Markets - Analyst*

Good morning. Big picture question about Campbell's improving towards it long-term algorithm. I am imagining this year that Plum, Bolthouse, V8, those are going to be areas of improvement this year and perhaps you can comment on that. But thinking longer-term, one issue and I think Chris was hinting at this on his question, Campbell has been improving somewhat in the meal helpers, the sauces, the cooking soups essentially helping the millennials and others prepare meals and participating in that importantly in a higher-margin way for Campbell. And over time it is certainly believable that there could be a tipping point when these platforms again higher-margin platforms for Campbell could start to carry the P&L, contribute on revenue in a way that isn't one where you are fighting the gross margins of the products that you are growing with. Can you comment on that and perhaps when you could see a tipping point like that? Thanks.

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

Well, first of all, I don't think I could have articulated the strategy any clearer than you did. So thank you for that. I think that as opposed to a tipping point, I think we are starting to see the impact of some mix change as these particular faster growing businesses come into the portfolio and are now captured in our organic sales. And I liken it to what we did with aseptic broth. Once upon a time broth was a canned business and over time we introduced the aseptic cartons and the cans gradually declined, the aseptic cartons of broth increased at a very significant margin. So we were pretty excited about that and I think it is these other businesses will come into the portfolio and mix accordingly.

But that said, we are still putting a very concerted effort on our core businesses to strengthen them as well.

David Palmer - *RBC Capital Markets - Analyst*

I guess my major, the big question, the million dollar question is whether these sauces and helpers essentially can -- and sometimes it is hard for us to tease that out of your general soup numbers because some of these are cooking soups, when those will again carry that line item in a margin accretive way. I guess that will be for us to just wait and watch.

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

Yes, I think that is right. One of the things we do know is that these types of products are attracting a more affluent and younger consumer into our franchise and we are very encouraged by that.

David Palmer - *RBC Capital Markets - Analyst*

Thank you.

Operator

(Operator Instructions). Matthew Granger, Morgan Stanley.

Matthew Grainger - *Morgan Stanley - Analyst*

Good morning, everyone. Just to drill down on one of these newer business lines, I was surprised to see profitability down pretty sharply in the Bolthouse and Foodservice segment and granted one quarter but you are obviously generating strong topline growth on Bolthouse, Foodservice seems to be in a more stable position. So is the margin contraction here during the quarter a function of the timing of investments in new products or should we think about there perhaps being Bolthouse specific cost pressures that could persist over the course of the year or are there other factors that play just here during the quarter?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

Matt, there are a couple of things. Within Bolthouse, the CPG businesses, so beverages and salad dressings grew both top and bottom line. The issue within Bolthouse has been carrots so there has been some significant inflation in there. It is partly due to the drought so we have had higher water extraction costs and higher land costs. We also had higher freight costs. We were growing up in Washington state and trucking down to California and since the first quarter that production has moved to central California so that should help a bit.

The other impact is on the Foodservice business so not in Bolthouse, significant cost inflation in the Foodservice product and also some investments we are making to expand our retail fresh business. So it is a combination of those things.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay. So it is fair to say it may not be the same magnitude but some of these things directionally could continue to pressure operating profit for the next few quarters?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

I would expect things to get better.

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

Yes, we expect improvement.

Matthew Grainger - *Morgan Stanley - Analyst*

Okay. Thank you, everyone.

Operator

Bryan Spillane, Bank of America.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Good morning everybody and happy Thanksgiving. Just wanted to ask a question about M&A. And Denise, we are now a couple of years into this current strategy and you have been very articulate and clear about where the M&A targets are but at the same time, there has been -- there's two things that have probably shifted more in the last three years. One has been this trend towards or the size of the impact on health and wellness has become more pronounced and larger in the US. And then also international, especially developing and emerging markets at least right now have slowed and I think there is a lot of mixed opinions in terms of when it turns and how it turns and where it turns.

Can you just talk a little bit about how you have looked at those dynamics changing and if at all it begins to have you kind of refocus or adjust at all your lens for where you are looking to do acquisitions? Thank you.

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

So we have said previously that some acquisition may be required to further diversify our portfolio and we still believe that to be the case. But that said, we have also said and still are very tight with this, we have a very disciplined approach to how we evaluate acquisitions and the strategic fit of acquisitions into our program here.

That said, we do have the financial flexibility to make a meaningful acquisition if we can find one that is a good fit and gives us the returns that we would expect to create value over time. So we still are active in this space but we are being very disciplined about our approach to it.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Has there been any change in focus areas or areas we are looking just because the global economy has slowed, things are slower in developing and emerging markets and there seems to be an increased certainly appetite in the investment community but also just broadly health and wellness related products and categories because it would expand, has that all changed the areas where you are looking or is it still sort of the same basket, same proportions in terms of where you were looking?

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

If you think about the acquisitions that we have made, Plum Organics and Bolthouse Farms in package fresh have both been we believe very solid plays in health and wellness and the Kelsen business was a good add for us for international expansion particularly with 40% of sales in China and Hong Kong. We will continue to look for targets similar to those kinds of acquisitions.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Just one last one related to this, just in terms of investment, so rather than M&A, is there any more broad thought to just changing -- making investments organically in your own business to adjust towards simpler ingredients or more health and wellness above and beyond what you have already done so something that might maybe change production processes or change ingredients? Is that at all part of what you are looking at in terms of your investment dollars? Thank you.

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

I think if you really look at the platforms for growth in addition to what we just discussed, we've got a concerted effort on breakthrough innovation and one of the platforms in breakthrough innovation is health and well-being because we've got V8 Veggie Blends coming, V8 protein bars and shakes, we have got advances in innovation in Bolthouse Farms and Plum and we have the new Campbell organic soups coming to market. So we are very active in innovation in the health and well-being space.

Package Fresh, we just talked about and then also increasing our availability. We've got an enormous opportunity in other channels outside of grocery particularly in immediate consumption channels that we are in the process of building out that network. We put a sales team in place and we still have a lot more work to do there but that is a great expansion space for us.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Akshay Jagdale, KeyBanc.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Good morning. Thanks for taking the question and happy Thanksgiving. My question is on freight cost. Can you talk a little more broadly about freight cost? A lot of companies have been mentioning that in the food space as being a headwind. Is seems like a general industry trend that sort of snuck up on us. Is that the case? What is your read on that and is it sort of a transitory issue and perhaps how long might that last?

Anthony DiSilvestro - *Campbell Soup Company - SVP of Finance and CFO*

I think it really stems from the carrier capacity situation and there is just significantly more demand than there is availability especially on the spot market so it hit us two ways this quarter. One, just a general increase in freight rate. The other, because of our volume demand, we had to access the spot market and the higher proportion than we have done in the past. And what we are doing about it is we are trying to get more committed carrier capacity in our highest volume freight lanes and that will protect us from coming to the spot market. You may have to pay a little bit more but it gives us some protection and our supply chain group is in the process of doing it right now. So it will be a negative impact but it should moderate as we go through the year here a bit.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Thank you. I will pass it on.

Operator

Alexia Howard, Sanford Bernstein.

Alexia Howard - *Sanford C. Bernstein - Analyst*

Thank you for the follow-up question. Can I just ask about the shift into digital on both the advertising and promotional front? A number of companies have been saying that promotional spending particularly has been getting less effective of late. I am just wondering how quickly you are shifting into digital on both advertising and promotion and how you can be confident that that is giving you better effectiveness as you make that shift? Thank you.

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

Yes and we have been experiencing and encouraging the same shift into digital. We are up to about 20% of our spending in digital and what happens, it is -- the production costs of digital are less but you need to produce more content so there is a bit of an offset there. So yes, you could see non-working come down because of the price of producing in digital but then again it is a different kind of production and making sure that content is fresh and works on multiple screens sizes. But we do believe that this shift will continue. This is the way to connect with the next generation of consumers. We still do have a significant portion of our spend in TV because of our large baby boomer population that still watches TV as their major media.

Alexia Howard - *Sanford C. Bernstein - Analyst*

Thank you very much. I will pass it on.

Jennifer Driscoll - *Campbell Soup Company - VP of IR*

Thanks, Alexia. Thanks to all of our callers for those questions. Happy Thanksgiving from all of us at Campbell and thank you for joining our first-quarter earnings call. A full replay will be available about two hours after the call concludes. Go online to get it or call 703-925-2533. The access code is 1647199. You have until December 9 at midnight at which point we will move our earnings call strictly to the website, investor. CampbellSoupcompany.com under news and events, then click on recent events, recent webcast and presentations.

Our next earnings call is February 25, the week following the Consumer Analyst Group of New York event and our CAGNY presentation and luncheon is confirmed for Wednesday, February 18. If you have further questions, call me Jennifer Driscoll at 856-342-6081. If you are a reporter who has questions, please call Carla Burigatto, Director of External Communications at 856-342-3737.

We now conclude today's program. You may disconnect.

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